



NAVAL POSTGRADUATE SCHOOL

MONTEREY, CALIFORNIA

THESIS

**THE OLIVE BRANCH AND THE HAMMER: A
STRATEGIC ANALYSIS OF HAWALA IN THE
FINANCIAL WAR ON TERRORISM**

by

Daniel Adam Hancock

March 2008

Thesis Advisor:
Co-Advisor:

Robert E. Looney
James A. Russell

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REPORT DOCUMENTATION PAGE			<i>Form Approved OMB No. 0704-0188</i>	
Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instruction, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188) Washington DC 20503.				
1. AGENCY U.S.E ONLY (Leave blank)		2. REPORT DATE March 2008	3. REPORT TYPE AND DATES COVERED Master's Thesis	
4. TITLE AND SUBTITLE The Olive Branch and the Hammer: A Strategic Analysis of Hawala in the Financial War on Terrorism			5. FUNDING NUMBERS	
6. AUTHOR(S) Daniel Adam Hancock				
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Naval Postgraduate School Monterey, CA 93943-5000			8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING /MONITORING AGENCY NAME(S) AND ADDRESS(ES) N/A			10. SPONSORING/MONITORING AGENCY REPORT NUMBER	
11. SUPPLEMENTARY NOTES The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government.				
12a. DISTRIBUTION / AVAILABILITY STATEMENT Approved for public release; distribution is unlimited			12b. DISTRIBUTION CODE	
13. ABSTRACT (maximum 200 words) <p>Since September 11, 2001, U.S. counter-terror efforts to disrupt al Qaeda's finances have been imprecise at best; at worst, they have had profound negative effects. The question of why hawala poses such a great threat and why there is a need for strict regulation or elimination of hawala has been the subject of great deliberation among policy makers and financial scholars since al Qaeda's attack on New York and Washington, D.C.</p> <p>The purpose of this thesis is to understand the complexities of the hawala informal financial transfer system prevalent in the Middle East and assess its complicity with terrorist financing. To that end, this thesis examines whether the hawala system itself pose a significant terrorist threat to the United States as a medium for financial transactions for terrorist organizations.</p> <p>By conducting a detailed analysis of <i>hawala</i> in Afghanistan from 2001-2006, this thesis provides a framework to assess whether the hawala system poses a strategic threat in the U.S. led "war on terror." Furthermore, by studying regulation attempts in Afghanistan, this thesis examines the cultural and economic effects of U.S. efforts on Muslims.</p>				
14. SUBJECT TERMS Hawala, terrorism, al Qaeda, war on terror, hawaladar, Afghanistan, informal finance, informal value transfer, Financial Action Task Force			15. NUMBER OF PAGES 95	
			16. PRICE CODE	
17. SECURITY CLASSIFICATION OF REPORT Unclassified	18. SECURITY CLASSIFICATION OF THIS PAGE Unclassified	19. SECURITY CLASSIFICATION OF ABSTRACT Unclassified	20. LIMITATION OF ABSTRACT UU	

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HAWALA IN THE FINANCIAL WAR ON TERRORISM**

Daniel A. Hancock
Lieutenant, United States Navy
B.S., United States Naval Academy, 2002

Submitted in partial fulfillment of the
requirements for the degree of

MASTER OF ARTS IN SECURITY STUDIES (MIDDLE EAST)

from the

**NAVAL POSTGRADUATE SCHOOL
March 2008**

Author: Daniel A. Hancock

Approved by: Robert E. Looney
Thesis Advisor

James A. Russell
Co-Advisor

Harold A. Trinkunas
Chairman, Department of National Security Affairs

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ABSTRACT

Since September 11, 2001, U.S. counter-terror efforts to disrupt al Qaeda's finances have been imprecise at best; at worst, they have had profound negative effects. The question of why *hawala* poses such a great threat and why there is a need for strict regulation or elimination of *hawala* has been the subject of great deliberation among policy makers and financial scholars since al Qaeda's attack on New York and Washington, D.C.

The purpose of this thesis is to understand the complexities of the *hawala* informal financial transfer system prevalent in the Middle East and assess its complicity with terrorist financing. To that end, this thesis examines whether the *hawala* system itself pose a significant terrorist threat to the United States as a medium for financial transactions for terrorist organizations.

By conducting a detailed analysis of *hawala* in Afghanistan from 2001-2006, this thesis provides a framework to assess whether the *hawala* system poses a strategic threat in the U.S. led "war on terror." Furthermore, by studying regulation attempts in Afghanistan, this thesis examines the cultural and economic effects of U.S. efforts on Muslims.

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ACKNOWLEDGMENTS

I would like to thank all of my professors at the Naval Postgraduate School for their wisdom and patience. Graduate school has been a profoundly rewarding intellectual experience for me, and I am grateful for the tutelage of the many talented professors in the Department of National Security Affairs at NPS who have helped sharpen my critical-thinking and increase my knowledge of the world in which I operate. I must especially thank Professor James Russell for his knowledge and mentorship in my Middle East curriculum and Professor Bob Looney for his guidance and expertise in this thesis process. I am grateful to each of you for your friendship, encouragement and direction in this endeavor.

I am thankful for the love and care that my parents fostered at home and their emphasis on education that has given me the freedom to pursue my dreams. I would like to thank my sisters for their inspiration and high academic achievements for which I have strived to match. Thanks to my younger brother who has inspired me with his courage and grit on his battlefield. You have the heart of a warrior.

I would be remiss if I failed to take advantage of this rare opportunity to publicly acknowledge the many sacrifices made by my own family on behalf of this country and me. I want to thank my son, Aiden, whose bright smile and unconditional love has made this assignment worth it, as well as Emma, who gives me pure joy and hope for the future. Most of all, I thank the love of my life, Elizabeth Joy, whose tireless devotion to me and to the Navy gives me the energy to keep going. Joy, you have adroitly managed the affairs of our home and family in my many absences. I thank you from the bottom of my heart for your all too often thankless service and many gifts. Without your love and steadfast support, I am a lesser naval officer and man. I look forward to each future day of this journey we walk together.

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I. TRUTH AND CONSEQUENCES IN THE PURSUIT OF AL QAEDA'S FINANCES: IS HAWALA REALLY A STRATEGIC THREAT?

A. INTRODUCTION

Since September 11, 2001, U.S. counter-terror efforts to disrupt al Qaeda's finances have been imprecise at best; at worst, they have had profound negative effects. The question of why *hawala* poses such a great threat and why there is a need for strict regulation or elimination of *hawala* has been the subject of great deliberation among policy makers and financial scholars since al Qaeda's attack on New York and Washington, D.C. Regardless, strategic banter became policy with the publishing of Executive Order 13224 which greatly expanded the U.S.'s ability to freeze, block and disrupt the transfer and storage of terrorist funds.¹ In the aftermath of 9/11, this executive order set the tone and direction for U.S. strategy to disrupt and infiltrate al Qaeda's financial network. EO 13224 created the framework for further debate that continues today. The debate is driven by the underlying assumption of policy makers that *hawala* was a fundamental piece of al Qaeda's financial repertoire, allowing al Qaeda to finance its global operations, particularly the 9/11 attack on America. This assumption is false. Its roots are in myth and post 9/11 histrionics. The truth of *hawala*'s bite is seriously lacking the teeth ascribed to it in recent years. It is in fact a paper tiger.

B. PURPOSE AND RESEARCH QUESTION

"Hawala is an alternative or parallel remittance system. It exists and operates outside of, or parallel to 'traditional' banking or financial channels."² *Hawala* transfers money from one party to another without actually moving it.³ In Arabic, *hawala* means

¹ Department of the Treasury, Contributions by the Department of Treasury to the Financial War on Terrorism Fact Sheet, (Washington, D.C: Treasury Department, 2002).

² Patrick M. Jost and Harjit Singh Sandhu, "The hawala alternative remittance system and its role in money laundering," Interpol, <http://www.interpol.int/Public/FinancialCrime/MoneyLaundering/hawala/default.asp>, (Accessed April 2007).

³ Ibid.

transfer. *Hawala* comes from the root Arabic word *h-w-l*, which means “change” or “transform.” *Hawala* has been around since 1770. It first emerged in Calcutta, India where no formal financial infrastructure or western banking system existed. Today, it exists as global phenomenon, providing a reliable outlet for financial transfers throughout the world, but it is especially prevalent in South Asia and the Middle East.⁴

The purpose of this thesis is to understand the complexities of the *hawala* informal financial transfer system prevalent in the Middle East and assess its complicity with terrorist financing. To that end, this thesis poses the following primary research question: Does the *hawala* system itself pose a significant terrorist threat to the United States as a medium for financial transactions for terrorist organizations? Secondary research questions are: Have regulatory frameworks been effective? Is it possible to create an effective and comprehensive regulatory framework for *hawala* in formal and informal financial sectors? What obstacles are in the way of an effective policy to reduce or eliminate illicit use of the *hawala* system? Lastly, what is the cultural and socio-economic impact in the Muslim world of U.S. financial counter-terrorism strategies for curbing illicit use of *hawala*?

C. LITERATURE REVIEW

1. Policy Makers’ School

With the terror attacks of 9/11, there was consensus among government officials that combating al Qaeda’s financial network would play a pivotal role. This spurred three bodies of literature, and two primary schools of thought. The most immediate school of thought that developed was led by policy makers. The central precept of this school of thought emerged quickly: freeze, disrupt, and eliminate anything that touches terrorist funds. President Bush punctuated this effort in his remarks shortly after September 11 announcing his executive order:

⁴ Jost and Sandhu.

This morning, a major thrust of our war on terrorism began with the stroke of a pen. Today, we have launched a strike on the financial foundation of the global terror network...we will direct every resource at our command to win the war against terrorists: every means of diplomacy, every tool of intelligence, every instrument of law enforcement, every financial influence. We will starve the terrorists of funding, turn them against each other, rout them out of their safe hiding places and bring them to justice.⁵

Then Secretary of the Treasury echoed the sentiment of the President:

If you have any involvement in the financing of the al-Qaeda organization, you have two choices. Cooperate in this fight, or we will freeze your U.S. assets. We will punish you for providing the resources that make these evil acts possible. We will succeed in starving the terrorists of funding and shutting down the institutions that support or facilitate terrorism.⁶

The central tenet of this school of thought, led by the president, the Treasury Department, and other policy makers, is a by-product of the Bush administration's greater "you're either with us or you're against us" strategy. This school has pushed for aggressive legislation with broad powers to freeze "terrorist" assets and disrupts its financial capabilities. The fruition of this logic is seen in EO 13224, U.S.A PATRIOT ACT, the investigation and prosecution of Islamic charities, the creation of Operation Green Quest (an inter-agency task force intended to collaborate the brunt of the U.S. financial expertise against financial terror), international collaborative efforts with the United Nations and the FATF (Financial Action Task Force), and intense rhetoric on the corruption of *hawala*. On the heels of the U.S. initiative, FATF responded to 9/11 by creating eight special recommendations aimed specifically at combating terrorism financing, including one for *hawala*.⁷ On October 10, 2001 the FATF issued special

⁵ George Bush. Remarks made September 24, 2001, released by the Office of the Press Secretary, <http://www.whitehouse.gov/news/releases/2001/09/20010924-4.html> (accessed April 2007).

⁶ Paul O'Neill, Remarks made Regarding the President's Signing of Executive Order 13324 Authorizing the Treasury Department to Block Funds of Terrorists and their Associates, released by Department of the Treasury, Office of Public Affairs, (Washington, DC: 2001), <http://www.treas.gov/press/releases/po630.htm> (accessed March 2007).

⁷ Samuel Munzele Maimbo and Nikos Passas, "The Regulation and Supervision of Informal Remittance Systems," *Small Enterprise Development* 15 (2004): 56.

recommendation VI (FATF SP.VI) that called on countries to register or license all informal remittance businesses and subject them to all FATF recommendations, whether a formal bank or a non-bank.⁸ The policy makers' school of thought has at times pursued aggressive policy based on ambiguous or inconclusive preliminary data.

2. Media School

Another body of literature has been built by numerous commentators with varying levels of expertise eager to get published on the hot topic of the day after 9/11: *hawala*. These commentators populate the media⁹ school of thought on *hawala*. Often, this school has been found to quickly speak, but not equipped with sound facts. This is evidenced by the widely held belief that terrorism, including al Qaeda, is financed through blood diamonds, the source of several sensational books published since 9/11. As Passas points out, this has simply been refuted by the 9/11 commission report and various law enforcement agencies.¹⁰ In several articles in this body of literature, some of the prominent names in the *media* school often repeat hearsay and hypotheses for fact. Passas highlights this distinct *media* trend, showing how five different authors essentially quote each other in their claims that al Qaeda uses rough diamonds from Africa to finance terror.¹¹ This is indicative of the sort of hyperbole and sensationalism in the *media* school of thought. Another popular myth of this school, now debunked, is that the 9/11 hijackers utilized the *hawala* system to fund and carry out their heinous acts.¹² *Hawala* is a popular topic in editorial, scholarly, and policy circles. There has been no shortage of those eager to write about *hawala*, however, often with sloppy scholarship.

⁸ Maimbo and Passas (2004), 56.

⁹ Similar to Passas' *media theory*

¹⁰ Nikos Passas, "Terrorism Financing Mechanisms and Policy Dilemmas," in *Terrorism Financing and State Response: A Comparative Perspective*, ed. Jeanne K. Giraldo and Harold A. Trinkunas (Stanford: Stanford University Press, 2007), 27.

¹¹ *Ibid.*, 27.

¹² Douglas Greenburg, John Roth, and Serena Wille, *National Commission on Terrorist Attacks Upon the United States: Monograph on Terrorist Financing* (Washington, DC: 9/11 Commission, 2004), http://www.9-11commission.gov/staff_statements/911_TerrFin_Monograph.pdf, (accessed May 20007), 139-40.

3. Financial Academia School

Finally, the most insightful school of thought has been developed within the financial circles of academia. The crux of this school of thought rests in the core belief that regulation of *hawala* needs to be tempered with patience, regional collaboration, socio-economic and cultural sensitivity, and broader formal financial reform. The consensus in this group is that efforts to date by the U.S. government and international community have been too aggressive and have not achieved their stated objectives. Rushing to too quick of recommendations and regulation will not benefit the U.S. in its long-term efforts to defeat al Qaeda. Maimbo and Passas argue that the practice of regulation has “preceded comprehensive theoretical debate and empirical research; this...may have serious adverse effects.”¹³ The essential question this school asks is: Can counter-terror strategies disrupt the illegal activity without inhibiting the scores of people who rely on *hawala* for legitimate and necessary financial needs?¹⁴

Another tenet of the scholars’ school of thought is that broader formal financial reform will have a more desired effect in reducing *hawala* misuse than direct external pressure and regulation on *hawala* through registration and licensing. Most countries consider *hawala* illegal. Thus, regulation is problematic. Regulation would implicitly recognize IFTs (informal fund transfers) as legitimate. There is agreement in this school of thought, though, that coercive measures will just drive *hawala* further underground.¹⁵ Looney affirms this assertion explaining that “a crackdown would simply drive them (hawalas) underground.”¹⁶ Looney argues that if registration and licensing fail to achieve the desired effect, then broader economic policies must be considered to make *hawala*

¹³ Samuel Munzele Maimbo and Nikos Passas, “The Regulation and Supervision of Informal Remittance Systems,” Working Paper, December 10, 2003, <http://www.inafi-la.org/espanol/docu/RegulationandSupervisionInformalRemittanceSystems.pdf> (accessed March 2007).

¹⁴ Maimbo and Passas, *Small Enterprise Development*., 57.

¹⁵ Mohammed El-Qorchi, “Hawala: Based on Trust, Subject to Abuse,” eJournal U.S.A: Economic Perspectives (September, 2004), <http://usinfo.state.gov/journals/ites/0904/ijee/qorchi.htm> (accessed March 2007).

¹⁶ Robert E. Looney, “Hawala: The Terrorist’s Informal Financial Mechanism,” *Middle East Policy*, 10 (2003): 166.

less attractive.¹⁷ Maimbo and Passas agree arguing that broader economic reform will have greater effect than swift and “direct external intervention.”¹⁸

Lastly, de Gourde gives voice to an important belief of this school: you must account for the socio-economic and cultural effects of any *hawala* regulation. He describes the “collateral damage” of aggressive seizure of “terrorist” funds by the U.S. in the case of *al Barakaat*, a large *hawala* firm based out of Somalia. Hundreds of thousands of Somalis relied upon *al-Barakaat* for financial services, but when their assets were frozen after 9/11, Somalis across the board were devastated. Furthermore, no convictions have occurred from this punitive regulatory action.¹⁹ *Al-Barakaat* fulfilled many economic services in a vacuum of a formal financial infrastructure in war-torn Somalia. Razavy says the failure of regulation to stop illicit *hawala* activities “reflects the lack of appreciation, on the part of authorities and policy makers, for the broader social and cultural context in which *hawala* operates.”²⁰

D. HYPOTHESIS

The three schools of thought all touch on one important theme: the importance of terrorist financing. While all three schools approach the *hawala* question with different lenses and motivations, the clear message is that *hawala* is worthy of further study, even if one can never reach a quantifiable measure of its effect in the al Qaeda financial network. Its importance is unclear, but it seems obvious that there is some vulnerability to illicit activity that certainly warrants deeper research.

This thesis attempts to contribute to the literature by exploring a simple yet overlooked question in all three schools of thought: Is *hawala* really that big of a threat? Do we need regulation at all? While most scholars have simply focused on the misapplication of regulation and its adverse effects in the broader “war on terror”, this work will build upon the scholars’ school of thought and attempt to show that the case for

¹⁷ Looney, 167.

¹⁸ Maimbo and Passas, 2003 Working Paper, 3.

¹⁹ Marieke, de Goede, “Hawala Discourses and the War on Terrorist Finance,” *Environment and Planning D: Society and Space*, 21 (2003): 525.

²⁰ Maryam Razavy, “Hawala: An Underground Haven for Terrorists or Social Phenomenon?” *Crime, Law, and Social Change* 44 (2005): 277.

al Qaeda's finances in general are over-stated and certainly *hawala* in turn, as a threat, is oversold. Succinctly stated, *hawala* is not a strategic threat in the financial war on terror, and furthermore, any heavy-handed attempts to regulate it while have profound negative socio-economic and cultural effects on Muslims in the Middle East, alienating the very people that the U.S. is counting on to prosecute the "war on terror" and curb "extremist Islam." In answering the primary research question, this thesis will answer its subordinate research questions: has *hawala* regulation had any effect? What are the cultural and socio-economic implications of current policy? Is it even possible to effectively regulate the formal and informal sectors without driving *hawala* further underground?

E. METHODOLOGY

In an attempt to get the best measure of current regulatory frameworks' effectiveness, this author has determined that a comparative case study of Afghanistan from 2001-2006 is necessary. In concluding this thesis, it is useful to identify two other Muslim states for further study that are known to have vibrant *hawala* networks. To this purpose, the U.A.E. and Pakistan section of the conclusion provides a brief glimpse at two different approaches to *hawala* after a more lengthy and exhaustive examination of Afghanistan. U.A.E. has been heavily targeted by the U.S. and international community post-9/11 to curb the abuse of *hawala* for illicit purposes. It is widely accepted that U.A.E. has one of the largest *hawala* systems in the world, largely due to its enormous expatriate population. U.A.E. is also an interesting case study, because it is the first state to proudly volunteer to regulate *hawala* and ensure it is not "against us." The Central Bank of U.A.E. has enacted numerous reforms aimed at deterring illicit *hawala* activity. Consequently, U.A.E. seems a logical state to examine in attempting to answer my primary research question. Pakistan too has heavy *hawala* traffic. Contrary to U.A.E., Pakistan has been less forthcoming in acknowledging *hawala*'s prominence in its state. Nonetheless, it is a prominent Islamic state filled with tribal networks and allegedly a high terrorist density in its remote regions. That makes Pakistan's *hawala* network ideal to study, if only briefly.

Finally, the focus of this thesis is on Afghanistan which is another prominent Islamic state and since 9/11 is the most germane state to the U.S. led “war on terror.” In a unique evolvement of the *hawala* system, Afghanistan, primarily in Kabul, has a small network of self-regulated *hawaladars*. This unique iteration gives a completely different look to U.S. counter-terror strategies. Additionally, Afghanistan, like its eastern neighbor, is generally agreed to be a nexus of terror suspects and a hot spot in the U.S. led “war on terror.” Therefore, it is logical that if *hawala* is being manipulated for illicit purposes, Afghanistan’s *hawala* network would make a great case study to examine through the lens of the primary and secondary research questions.

By conducting a detailed analysis of *hawala* in Afghanistan from 2001-2006 and in a few words comparing it to Pakistan and the U.A.E., this thesis attempts to prove its primary hypothesis to be true: *hawala* as a component the war on financial terror is not a strategic threat. Furthermore, this thesis attempts to show that any broad regulation has been non-effective, and in fact counter-productive, alienating scores of innocent Muslims and galvanizing regional support away from U.S. foreign policy while pushing Muslim sympathies toward al Qaeda. The incongruence of American foreign policy in the financial “war on terror” has been damaging. America has extended the olive branch to the Muslim world in rhetoric while wielding a deadly financial hammer with the other hand.

II. UNVEILING HAWALA

A. CONCEPTUAL FRAMEWORK

In Arabic, “hawala” means “transfer.” In a larger sense, it is often associated with any money exchange system that operates outside of a formal financial sector. The *hawala* system typically involves the transmission of remittances from one country to another through an intermediary, called a *hawaladar*. Some have labeled *hawala* an “underground” system. This is false, as most *hawaladars* operate openly, advertising publicly and serving legitimate needs of their customers.²¹ Another prevalent label for *hawala* is that of an “alternative remittance system.” This label is misleading because it obscures the fact that in many areas *hawala* is the only available financial system.²² Afghanistan and Somalia are but two examples of states where reliable financial mechanism are so scarce, even aid organizations use *hawala*. Sifting through the literature, Passas introduced the most widely accepted term that encompasses *hawala* operations: informal value transfer systems (IVTS). Passas defines IVTS as “mechanisms or networks of people facilitating the transfer of funds or value without leaving a trail of entire transactions taking place outside the traditionally regulated financial systems.”²³ The crux of the *hawala* system is simple, though: trust. It is *hawala*’s “defining characteristic.”²⁴

In laying the strategic framework for further study of *hawala*, Maimbo, el Qorchi et al drew an important distinction between two types of IVTS. Maimbo et al separate Informal Fund Transfer Systems (IFTS) or (IFT) from a transfer of pure value. Somewhere in between the two spectrums is the Informal Value Transfer Methods (IVTM).²⁵ Essentially, IFTs are well established and known in their communities. They

²¹ Jost and Sandhu.

²² Nikos Passas, “Demystifying Hawala: A Look into its Social Organization and Mechanics” *Journal of Scandinavian Studies in Criminology and Crime Prevention* 7 (2006): 48.

²³ Ibid., 48.

²⁴ Maimbo and Passas, 2003 Working Paper, 4.

²⁵ Passas, 48.

deal purely in financial assets. In contrast, IVTM transfer money and other values. Its most important connotation, though, is one of illicit activity.²⁶ IVTM routinely mask illicit activity with the transfer of seemingly innocuous or otherwise routine commercial transactions of goods or services.

B. HISTORICAL ROOTS

IFT systems developed along historic trade routes because of the inherent danger of carrying large sums of money and gold along routes besieged with bandits and thieves.²⁷ Despite their different names—(*fei-ch'ien* (China), *hui kuan* (Hong Kong), *hundi* (India), *hawala* (Middle East), *padala* (Phillipines), and *phei kwan* (Thailand), the development of IFT systems remains similarly entrenched in the need to secure financial transactions over great distances.²⁸ These IFT systems allowed money or gold to be transferred from one party to another without physically moving the funds. This provided safety and assurance to the customer that his transaction would occur without external disruption from robbers along the trade routes.

In China, IFT systems can be traced to the Tang Dynasty (618-907 AD). As China's economy boomed, there arose a severe need for a financial system that would allow workers to send taxes, pay and other funds. The creation of the *fei-ch'ien* (which means flying money, literally, flying coins) met this demand.²⁹ This remittance system continued in China through the Ming and Ch'ing dynasties. Another catalyst in China was the cotton trade, whose need for fund transfers effectively made *fei-ch'ien* a China-wide system.³⁰

²⁶ Passas (2006), 48.

²⁷ Mohammed El-Qorchi, "Hawala: How does this Informal Funds Transfer System Work, and Should it be Regulated?" *Finance & Development* 39 (2002): 31.

²⁸ Mohammed El-Qorchi, Samuel Munzele Maimbo, and John F. Wilson, *Informal Funds Transfer Systems: An Analysis of the Informal Hawala System*, (Washington D.C.: IMF, 2003): 10.

²⁹ *Ibid.*, 10.

³⁰ *Ibid.*, 10.

On the India sub-continent, *hundi* developed before there were available western banking systems.³¹ Jost explains *hundi* in context to India's banking system. He writes:

The first western bank in India was the Bank of Hindustan, established in Calcutta around 1770. Prior to this, the operations of *sarafs* and *potedars*, who were primarily moneychangers (and essentially the predecessors of *hawaladars*) were a fundamental component of the commercial and financial infrastructures.³²

Hundi is extremely old and pre-dates modern banking. As El-Qorchi et al explain, *hundi* has "been in vogue in India from time immemorial."³³ Only recently has *hundi* become illegal.

In the Middle East, *hawala* has facilitated trade between those in one region, but also between regions and fiefdoms. There are some historical accounts of *hawala* practices being widespread centuries ago. Hawala instruments were referred to as *attalaa*. *Attalaa* was a bill that a debtor wrote his name on and sealed, which protected the intermediary in moving between regions.³⁴ The exact roots of *hawala* in the Middle East are unknown. Historical records that reference *hawala* are spotty at best. What is known with certainty is its vital importance as a financial mechanism today, largely due to the ever-growing expatriate population living throughout the Middle East.

C. MECHANICS AND OPERATION

The essential idea of *hawala* is to transfer money without physically transporting funds. The immediate fear of difficulty for law enforcement agencies, intelligence agencies, and counter-terror strategists is obvious: there is little or no paper trail.³⁵ However, it should be noted that transferring money without physically moving it is not an exclusive attribute of *hawala*. In this regard, *hawala* is similar to a myriad of other

³¹ Jost and Sandhu.

³² Jost and Sandhu.

³³ El-Qorchi, et al, 11.

³⁴ Ibid., 11.

³⁵ Jost and Sandhu.

wire transfer and options available in the formal financial sector.³⁶ One of its defining characteristics, though, is that there is simply no easy way to track the *hawala* process. Additionally, the mixing of legitimate and illegitimate *hawala* transactions makes the trail of *hawala* very complicated and very hard to disentangle legitimate from illegitimate activity.³⁷ There is no simple wire transfer that can be easily traced and monitored. *Hawala* activity, both illicit and licit, is generally layered and therefore all the more difficult to trace.³⁸ From a counter-terror standpoint, it's a daunting task from the start with no easy roads to follow.

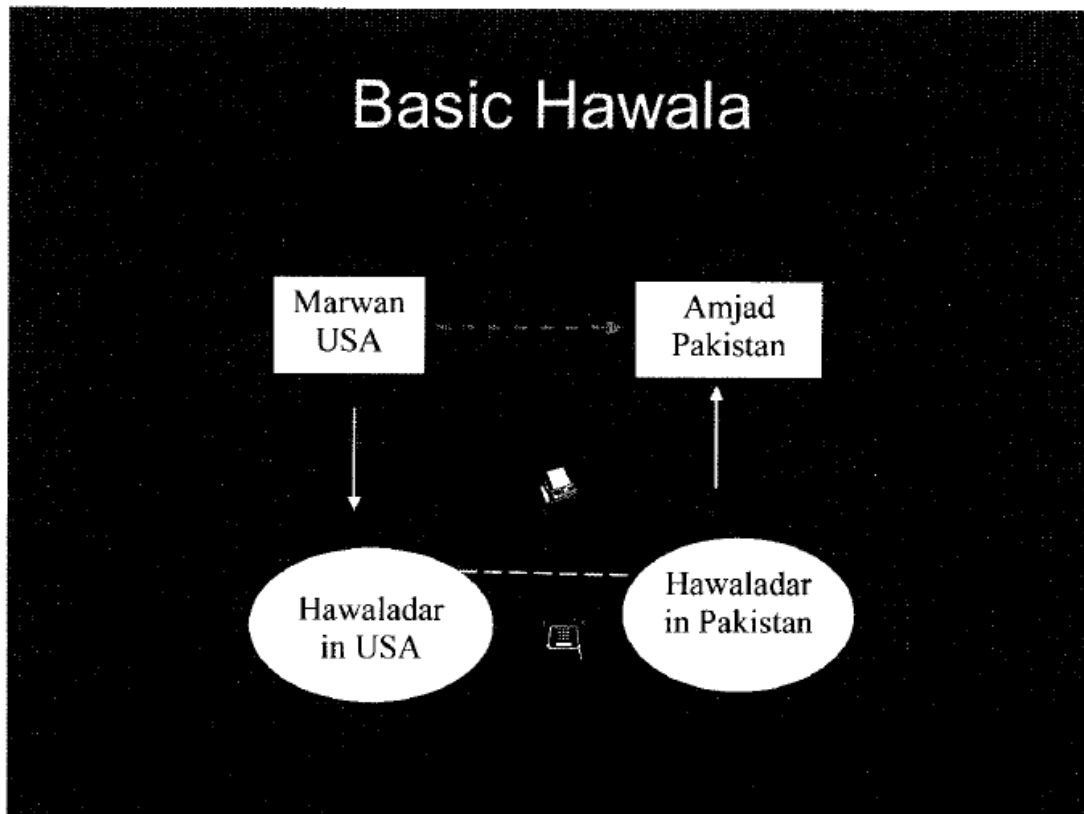


Figure 1. A Basic Hawala Transaction. (From: Nikos Passas)

³⁶ Nikos Passas, "Law Enforcement Challenges in Hawala-related Investigations," *Journal of Financial Crime* 12 (2004): 112.

³⁷ Passas (2004), 112.

³⁸ *Ibid.*, 112.

In its simplest mechanical form, *hawala* has four parties: a customer, an intermediary (*hawaladar*), a *hawaladar* in another region or state, and the recipient of funds. A typical *hawala* transaction will involve an expatriate remittance.³⁹ For example, a young worker in the U.A.E. may wish to send his pay, or a portion of it, back to his family in Afghanistan. The worker contacts a *hawaladar* in Dubai, U.A.E.. The *hawaladar* arranges the transfer by calling a *hawaladar* in Kabul, Afghanistan with whom he has done business with previously, and probably already has a close working relationship. The customer may pay in one currency, while the *hawaladar* in Kabul pays his family in the local currency. Often, *hawala* networks are marked by network and family connections. This is absolutely necessary for *hawala* to work so efficiently on such a large-scale regional basis.⁴⁰ “The closer are the relationships among *hawaladars*, the easier becomes the settlement process.”⁴¹

Since *hawala* transactions involve large amounts of cash, and the funds do not physically move from the customer in Country A to the recipient in country B, then there must be large amounts of cash at each end of a *hawala* transaction.⁴² This cash pool is a critical element of the *hawala* system and ultimately is what allows *hawala* to thrive. The trust that a fellow *hawaladar* will fulfill his end of a transaction with ready cash is critical to the fulfillment of a *hawala* promise, and to the professional reputation of each *hawaladar* involved. Cash makes the *hawala* system work.

D. ATTRACTIVENESS OF HAWALA

1. Speed and Efficiency

The appeal of *hawala* seems intuitive. It is cheap, efficient, reliable, quick, and in most cases, simply the best if not only option available for financial transactions. *Hawaladars* may only charge a commission from 0.25% - 1.5% to cover any fluctuations

³⁹ Looney, 165.

⁴⁰ Looney, 165.

⁴¹ Passas (2006), 52.

⁴² Ibid., 52.

in currency that may occur during the transaction period.⁴³ *Hawaladars* exploit the natural fluctuations in demand for different currencies and offer substantially better deals than formal banks can. They do not make their profit off fees like a formal bank does. Therefore the cost savings for the consumer is significant, in some cases 12-19%.⁴⁴

Hawala has no bureaucratic tangle that one might find in the formal financial sector. There, a fund request is made, and the banking system takes days and weeks to process the request on the other end. *Hawala* transactions are stream-lined; the method of *hawaladars* may be cell-phone, email, fax or other real-time devices such as blackberries. The result is that the process time is significantly reduced over the formal sector. In a short period of time, usually within twenty-four hours, the recipient in another region or state is in possession of the funds that the customers desired to be transferred, no matter how remote the location. This simple management structure allows for swift transactions that make *hawala* extremely appealing in comparison to suspect or non-existent formal mechanisms.⁴⁵ In some cases where *hawala* transactions occur between major international cities, the speed of *hawala* may increase to only six to twelve hours.⁴⁶

2. Limited Options for Remittances and Aid

For many in the Middle East and throughout the Muslim world, *hawala* is the only viable option for worker remittances. With the vast numbers of petro-dollars and petro-jobs, as well as other service related jobs created because of the oil boom in the Middle East, *hawala* is used extensively by expatriates to send home their wages. The convenience is too great. It is cheap, and it is widely available, no matter where you are, or no matter where you desire to send money. Additionally, *hawaladars*, unlike formal financial systems, are accessible twenty-four hours a day.

⁴³ Passas (2006), 57.

⁴⁴ Jost and Sandhu.

⁴⁵ El-Qorchi, *e-Journal U.S.A.*

⁴⁶ El Qorchi et al (2003), 7.

Another legitimate use of *hawala* is humanitarian relief and aid. Humanitarian organizations find *hawala* attractive because of the absent or entirely unreliable financial infrastructure existing in the war-ravaged countries that they are most likely to be operating.⁴⁷ This has been the case in Afghanistan and Somalia in particular. In these two countries, there is literally no other option. *Hawala* has served as a mostly reliable albeit necessary conduit for the transfer of relief fund into these decimated regions.

3. Cultural and Ethnic Factors

Hawala is also attractive because of many non-economic factors. “The kinship, ethnic ties, and personal elations between *hawaladars* and expatriate workers make this system convenient and easy to use.”⁴⁸ Customers often know the *hawaladars* personally. They are friends and neighbors. They share the same ethnic roots. They trust one another. Because of these close ties, *hawaladars* often make deals with customers to sweeten the attraction of their *hawala* services. For example, *hawaladars* often accommodate their clients by instructing their counterparts to pay the recipient before the expatriate has even paid the *hawaladar*.⁴⁹ It is a trust-based system. This type of extraordinary commitment on the part of the *hawaladar* makes the *hawala* system look too good to use another formal mechanism for remittances.

Cultural considerations also make *hawala* appear the best financial choice for any fund transfer. Since most expatriate communities are entirely male, this can create great difficulty on the receiving end of a remittance, where many states have social norms that preclude women from formal interaction with banks or other public services. In the case of *hawala*, *hawaladars* in the receiving country are known in the local or tribal regions, trusted, and sensitive to the cultural norms of a society. *Hawaladars* are acceptable intermediaries that allow women to successfully receive remittance wages from their family members abroad.⁵⁰ *Hawala*’s intimate intertwining with its clients’ society and

⁴⁷ El Qorchi et al (2003), 12.

⁴⁸ El Qorchi (2002), 32.

⁴⁹ Ibid., 32.

⁵⁰ Ibid., 33.

culture make it uniquely positioned to most effectively meet the transfer needs of most in the Middle East and Muslim society at large.

Hawala is going to thrive in the Muslim world with areas that lack or have reduced financial infrastructure. This is the case in much of the Middle East, especially in states the United States is targeting in its counter-terror efforts like Pakistan and Afghanistan. The more instable the situation on the ground is, the greater the state's proclivity for *hawala* will be. Slowed or repressed economic development will drive people to seek out other informal and more reliable fund transfer mechanisms such as *hawala*.⁵¹ *Hawala* exists as a viable option for many in most countries around the world. However, especially in the absence of any reliable formal mechanism for remittances or fund transfers, *hawala* continues to thrive.

4. Criminal Elements

Expatriates and workers in the Middle East are not the only ones who find *hawala* attractive. Criminal elements find *hawala* a useful tool for many reasons too. For reasons already stated, *hawala* provides great cover to illicit activity. There's little accountability, many claim there is shoddy or non-existing book-keeping by *hawaladars* and since it is a trust-based system, generally not too many questions are asked. It should be noted, however, that the record-keeping of *hawaladars* in Afghanistan has been found by several analysts to be meticulous and copious, completely refuting the suggestions of many that *hawaladars* do not keep accurate books. This is explained further in the case study of Afghanistan.

⁵¹ El Qorchi et al (2003), 33.

Passas highlights the advantages of hawala to the criminal or terrorist:

Hawala can hide criminal activity; legitimate financial and commercial activities can shield hawala operations; both of these can be obscured by ‘benami’ (false name) or nominee relationships; another layer of difficulty is added when transactions involve the use of more advanced technology (the internet) or funds go through ‘correspondent’ and ‘pass through’ accounts; additional layers of difficulty develop when such transactions go through national jurisdictions without transparency-enhancing bank secrecy laws, adequate money laundering legislation or effective enforcement; given that the settlement process in many IVTS transactions involved the trade in good and various commodities or smuggling, a further hurdle is raised when transactions pass through jurisdictions with porous borders or cash-based economics.⁵²

Hawala provides a plethora of loopholes and safety nets for those who would care to use *hawala* for illicit purposes. Because of its inherent traits, *hawala* makes disruption of such abuses extremely difficult and therefore all the more alluring to criminal elements.

5. Anonymity

Lastly, the anonymity of *hawala* transactions makes the *hawala* system attractive to both legitimate users and those who would use it to mask illicit criminal or terror-related activities. There is virtually no documentation required at any stage of a *hawala* transaction. No customer identification is required or needed except for a code that is used to mark the transaction and required in most instances for the recipient to claim the funds transferred. At best, customer identification is voluntary. If there are any documents pertaining to a *hawala* transaction, they are typically destroyed after the transaction is executed.⁵³ Again, it should be noted that this is the consensus of most *hawala* experts, but specifically in Afghanistan at least, *hawaladars* have been found to keep extremely detailed records of clients and transactions going back decades. There is warmth in anonymity that comforts legitimate users of *hawala* who are distrustful of

⁵² Nikos Passas (2004), 112.

⁵³ El Qorchi, et al (2003), 9.

formal state mechanisms as well as for criminals who simply do not want their illegal activities to be monitored or disrupted. El Qorchi et al demonstrate the potential for abuse by terrorists:

<p><u>Setting:</u> Robert lives in Country A; Michelle lives in Country B. They decide to carry out an action in Country A.</p> <p><u>The operation:</u> Michelle pays a hawaladar in Country B (HB) \$1,000 to have the equivalent delivered to Robert in Country A. HB contacts a hawaladar in Country A (HA) via phone or fax to arrange the payment. Robert receives the \$1,000 equivalent in short order. Neither HA nor HB is privy to the reasons behind the transaction.</p> <p><u>Technical traces:</u> One phone call or fax between HB and HA.</p> <p><u>Institutional involvement:</u> None except, perhaps, HA withdraws \$1,000 equivalent from his local account</p> <p><u>Institutional records:</u> None.</p> <p><u>International transaction:</u> None.</p> <p><u>Effect of money-transfer reporting requirements:</u> Probably none.</p>
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Figure 2. Possible Terrorist Hawala Transaction. (After: World Bank and IMF)

E. MAKING MONEY: WHAT'S IN IT FOR THE HAWALADAR

One of the reasons why *hawala* is so attractive to potential customers is because it is cheap. The reason it is so cheap is because of the low-overhead costs associated with *hawala* transactions. *Hawaladars* may operate from a rented storefront shared with another business down or from a modest table set up in a tea shop.⁵⁴ There is very little cost associated with the minimum necessities to conduct *hawala* transactions. In reality, all a *hawaladar* needs is a reliable phone or maybe a computer with internet access. A *hawaladar* can literally operate from anywhere with little or no incurred costs above the cost of any legal business the *hawaladar* might also be conducting. The average direct cost for a *hawala* transactions between major international centers such as Dubai and New York is between two and five percent.⁵⁵

⁵⁴ Jost and Sandhu.

⁵⁵ El Qorchi, et al (2003), 7.

Hawaladars operate to make a profit. They offer a phenomenal deal to locals and expatriates, but their motives are not purely to play to cultural sensitivities. They want to make money. To this end, *hawaladars* buy and sell different currencies. Each *hawaladar* attempts to profit by “buying a currency at a lower rate than he sells it for.”⁵⁶ The profits are at the margins of the *hawala* system. *Hawaladars* simply have to beat the prices they use to turn a profit. This is the bottom line: *hawaladars* profit to the extent that they can win the bargaining war within the *hawala* system and get a better currency price from other *hawaladars*.⁵⁷

Though *hawaladars* are maximizing profits through direct bargaining with one another for the best price, the *hawala* system is generally profitable compared to the formal financial sector because of the difference between official and unofficial exchange rates. The wider the margin between official currency rates and the informal *hawala* currency rates, the greater potential for profit by *hawaladars* who can pass on greater savings to the customer.⁵⁸ Through exploitation of exchange rates, selling cash, commissions and fees, trade financing, and recruitment of clients for legal businesses by virtue of *hawala*’s inherent benefits, *hawala* proves to be a very profitable mechanism.

F. THE EXTENT OF HAWALA

The extent of *hawala* remains unclear due to the lack of accountability and long-term records, or at least the accessibility of *hawaladars*’ records. *Hawaladars* appear to only be limited by the amount of cash they are willing to carry or the amount the executing *hawaladar* has on hand to cover a transaction.⁵⁹ While the predominance of usage of *hawala* is in South Asia and the Middle East, the system has global capacity. *Hawaladars* operate in New York, ethnic Pakistani neighborhoods in San Francisco,

⁵⁶ Passas (2006), 56.

⁵⁷ Ibid., 57.

⁵⁸ Ibid., 57.

⁵⁹ Looney, 165.

London, and especially in the Middle East. Perhaps the *hawala* epicenter in the Middle East is Dubai, United Arab Emirates. U.A.E.'s substantial *hawala* sector is generally attributed to its robust expatriate population.

Even if there is no quantifiable measurement of *hawala* due to its informal nature, there is every reason to believe it is an expansive network with millions flowing through it. Pakistan, while refusing to admit the *hawala* system's legality or legitimacy, has estimated the amount of money in its *hawala* system at more than \$5 billion per year, constituting Pakistan's largest source of foreign currency. Most of this is expatriate remittances from Pakistanis abroad back to their families. It is also believed that Pakistanis may have overseas holdings roughly equal to Pakistan's gross domestic product.⁶⁰ India also has a huge *hawala* presence. Interpol places India's *hawala* at approximately 40% of its GDP. At the turn of the century, this was roughly the size of Canada's economy.⁶¹

G. ECONOMIC IMPLICATIONS

The *hawala* system has profound economic impact on every state in which it exists. Neither end of the *hawala* transaction knows exactly what the status of financial assets is for his country. Increased assets for the receiving country and liabilities for the sending state are unaccounted for. "Value changes hands, but broad money is unaltered."⁶² The reality, though, is that broad money often is affected by *hawala* transactions in the receiving countries. Additionally, *hawala* transactions are usually marked by the use of cash in payment. The net result is that *hawala* transactions tend to flood recipient countries in cash that is not officially accounted for in economic measurement or planning.⁶³

⁶⁰ Looney, 166.

⁶¹ Scott Baldauf, "The War on Terror's Money-India's Six Month Investigation Offers Lessons on Fighting Underground Banking," *Christian Science Monitor*, July 22, 2002.

⁶² El-Qorchi (2002), 33.

⁶³ *Ibid.*, 33.

III. MISTRUST AND REFORM: AN ANALYSIS OF HAWALA IN AFGHANISTAN

A. INTRODUCTION: FUNDAMENTALISM REBORN

In May 2003, then-Secretary of Defense Donald Rumsfeld suggested that the war in Afghanistan was in a “cleanup” phase. Now, four years after Rumsfeld’s statement and five and a half years since the conclusion of major Operation Enduring Freedom (OEF) combat operations, it is clear that Afghanistan is anything but a stable and secure country. Indeed, the situation in Afghanistan has become extremely volatile.⁶⁴

Before the thick cloud of dust and debris had begun to dissipate at Ground Zero, Afghanistan, a state that had largely been forgotten since the last Soviet retreated back across its border in 1989 became the center of attention in a massive, worldwide collaboration. Led by the United States, this conglomerate was intent on striking back at bin Laden and his al Qaeda network that had worked, plotted, and trained unimpeded and largely un-noticed by the rest of the world in the remote regions of Afghanistan until the morning of September 11, 2001. In the metaphorical Global War on Terror being waged by the United States, the importance of Afghanistan cannot be overstated.⁶⁵

Afghanistan’s role in facilitating the financing of terror cannot be overstated, either. But while focusing on the financial underpinnings of al Qaeda’s terror network, it is nonetheless imperative to understand the context in which any abuse of *hawala* or terror financing occurred in the first place. Afghanistan produced a global Salafist movement led by a battle-hardened cadre of Arabs who fought there against the super-power Soviets. This movement captivated much of the Muslim world. Saudi Arabia began contributing to the movement financially and this gradually began to spawn much more interest in fundamentalist organizations on the ground in Afghanistan and

⁶⁴ Thomas H. Johnson, “On the Edge of the Big Muddy: The Taliban Resurgence in Afghanistan,” *China and Eurasia Forum Quarterly*, 5 (2007): 93.

⁶⁵ Thomas H. Johnson, “The Origins and Financing of Afghan Terrorism: Thugs, Guns, Drugs, Interlopers and Creative Movements of Money,” DRAFT for *Terrorism Financing and State Response: A Comparative Perspective*, ed. Jeanne K. Giraldo and Harold A. Trinkunas (Stanford: Stanford University Press, 2007), 1.

throughout the region. As volunteers began to show up to fight against the Soviets their ideas cross-fertilized. Thousands began to show up; Saudi Arabia was happy to pay for one-way tickets for their internal radical groups to leave and fight another enemy.

The Arab Afghans were often unwanted renegades in their own countries...These abandoned idealists were naturally looking for a leader. They had little to cling to except their cause and each other...They saw themselves as a borderless posse empowered by God to defend the entire Muslim people. This was exactly bin Laden's dream.⁶⁶

The result of bin Laden and the Arab jihadists in Afghanistan is that they became highly radicalized in an under-governed Afghanistan. Left to their own vices, they were free to raise funds, move money through the informal sector, plan, and exploit the non-existent regulatory oversight. They were not thinkers, but doers, and took a bare-knuckles approach that spawned al Qaeda later.⁶⁷

Afghanistan provided free space for training and building an Al Qaeda army. It allowed a nebulous movement like al Qaeda to build financial capacity and operational expertise. The devastating results of America's own involvement in the anti-Soviet jihad came back to haunt the U.S. twelve years later as this once harmless band of jihadists, now fully-funded and doctrinally strong, turned its ire to the West. From the shadows of Afghanistan, they struck a devastating blow to another superpower. How did al Qaeda fund its terrorist activities? A further look at *hawala* reveals the form and methodology of terror financing in Afghanistan used by al Qaeda, the Taliban, drug runners and others who have undoubtedly manipulated the informal sector with impunity.

B. FINANCIAL TERRORISM IN AFGHANISTAN: BACKGROUND ISSUES

There are four primary financial underpinnings to Afghanistan-based terrorism: assistance from sympathetic states (including the U.S. during the anti-Soviet jihad), Arab

⁶⁶ Lawrence Wright, *The Looming Tower: al Qaeda and the Road to 9/11* (New York: Alfred A. Knopf, 2006), 105-106.

⁶⁷ Vali Nasr, Remarks at the Naval Postgraduate School, May 21, 2007.

contributions and abuse of the *zakat*⁶⁸, narcotics and drug trafficking, and *hawala*.⁶⁹ While all four financial vehicles are important and worthy of further analysis, pursuant to the objectives of this thesis, consider for now the role of *hawala* in Afghanistan. Through a thorough analysis of the *hawala* system and how illicit funds enter the network, policy makers will be better able to understand its intricate workings and curb illicit abuse by terrorist organizations such as al Qaeda.

Hawala in Afghanistan has always played an important role in the financial sector, but especially in recent decades. “After more than 20 years of conflict in the country, Afghanistan’s formal financial sector is virtually non-existent. The conflict has resulted in the complete disruption of domestic and international payment systems, the virtual cessation of all lending activities within the country, significantly reduced deposit taking activities, and a stoppage of most international banking relationships.” Maimbo adds: “The disruption to the provision of financial services was most acute during the reign of the Taliban government when Afghanistan was subjected to international sanctions.”⁷⁰ During this period of turmoil, *hawala* filled a necessary role left void because of the financial sector’s inability to meet the most basic financial service needs of the Afghan people.

Until the fall of the Taliban in 2001, the informal sector, namely *hawala*, was the only reliable service in play. While formal financial institutions were non-existent or incapacitated by sanctions and war, *hawala* provided a cheap, efficient, and cost-effective alternative that could be trusted by the Afghan people.⁷¹ In the absence of an internationally recognized and legitimate government, the informal *hawala* sector’s

⁶⁸ One of the five pillars of Islam. It is an annual alms tax or tithe of 2.5% levied on wealth and distributed to the poor. It is a manifestation of the fact all faithful Muslims are duty-bound to attend to the social welfare of their community by redressing economic inequalities through payment of an alms tax. John L. Esposito, *Islam: The Straight Path* (New York: Oxford University Press, 2005), 90.

⁶⁹ Johnson DRAFT, 24.

⁷⁰ Samuel M. Maimbo, “The Money Exchange Dealers of Kabul: A Study of the Hawala System in Afghanistan”, World Bank Working Paper No. 13, 2003.

⁷¹ Maimbo (2003), 1.

hawaladars, or money service providers, became “key economic agents”⁷² in Afghanistan. Even as the formal financial sector has seen growth and improvement since 2001, the *hawala* network remains a central cog in the financial networks of Afghanistan.

C. MAPPING HAWALA: THE SCOPE AND EXTENT OF AFGHANISTAN’S HAWALA SYSTEM

1. Size

The magnitude of *hawala*’s footprint in Afghanistan is colossal. The World Bank estimates that a whopping 80-90% of all economic activity in Afghanistan is in the informal sector.⁷³ With *hawala* dominating the financial world of Afghanistan, it seems rather intuitive that illicit funds from drugs and terrorism are present in the system. Such cultural precision, though, seemed lost on policy makers in the U.S. government who settled on a more heavy-handed approach to *hawala* after 9/11.⁷⁴ Al Qaeda used *hawala* for the same reasons that hundreds of NGOs and international aid organizations did. There was no alternative. “Al Qaeda moved much of its money by *hawala* before 9/11. In some ways, al Qaeda had no choice after its move to Afghanistan in 1996; the banking system there was antiquated and undependable.”⁷⁵

Surprisingly, with 80-90% of the entire Afghan economy generated from one sector, there are only a few hundred *hawaladars* that operate the entire *hawala* network. There have been two significant studies that help us sketch the size and numbers of the *hawaladars* and *hawala* markets in Afghanistan. Maimbo’s seminal effort to *hawala* literature that focuses on the money dealers of Kabul estimates that there are 300 registered *hawaladars* in Kabul and 500-2000 total throughout Afghanistan.⁷⁶ Edwina Thompson, in her cogent contribution to the study of the opium problem in Afghanistan,

⁷² Edwina A. Thompson, “The Nexus of Drug Trafficking and Hawala in Afghanistan,” in *Afghanistan’s Drug Industry: Structure, Functioning, Dynamics and Implications for Counter Narcotics Policy*, ed. Doris Buddenberg and William A. Byrd (Washington, D.C: World Bank, 2006), 155.

⁷³ *Ibid.*, 155.

⁷⁴ This will be addressed specifically in a later section of this chapter.

⁷⁵ Greenburg et al, 25.

⁷⁶ Maimbo (2003), 3.

places the number of significant shops in the country at 900.⁷⁷ Finally, based off 2004 interviews conducted in Afghanistan by the Treasury Department, the number of *hawaladars* is estimated to be slightly over 300 in the Kabul Money Exchange, and potentially 100-300 additional dealers scattered in each region to service each of Afghanistan's thirty-four provinces.⁷⁸ Whatever the exact number, it is clear that a relatively few *hawaladars* control a vast and powerful financial network.

2. Volume

The amount of money flowing through the *hawala* network is tremendous. Maimbo elaborates:

Since the fall of the Taliban regime, the volume of financial flows through the *hawala* system has grown significantly. NGOs alone are estimated to have channeled at least U.S. \$200 million in emergency, relief, and development funding through the *hawala* system.⁷⁹

While typical international transactions are in the U.S. \$100,000 - \$200,000 range, single transactions between major financial centers such as Kabul and Peshawar in excess of U.S. \$500,000, or even U.S. \$1,000,000 transactions by international organizations are not unusual. However, internal transactions tend to be in the U.S. \$10,000 – \$20,000 range.⁸⁰

The overall volume of money in the *hawala* market in Afghanistan is difficult to determine with any certainty. Due to the informal nature and general secrecy of *hawala*, “any estimate of the overall size of the *hawala* market in Afghanistan should however be

⁷⁷ Thompson, 156.

⁷⁸ These figures were based on conversations by Treasury officials with Afghans staffed in the Supervision Department of the Central Bank as well as with several Money Exchange Dealers in the Kabul Hawala market.

⁷⁹ Maimbo, 4.

⁸⁰ Ibid., 4.

viewed with extreme caution.”⁸¹ Nonetheless, Thompson provides a healthy estimate of what *hawala* flows look like in Afghanistan.⁸²

Table 6.1: Rough Estimates of Aggregate *Hawala* Flows in Afghanistan (2004-2005)

Item	Inflow (US\$ million)	Outflow (US\$ million)
Opium trade~	1,700	?
Unofficial re-exports^	1,100	1,000
UN agencies*	500	?
NGOs**	1,300	?
Inward remittances and informal investments***	1,000 - 1,500	?
Imports of goods	---	?
Expatriation of opium profits	---	?
Other outward capital movements	---	?
Total:	5,600 - 6,100	5,600 - 6,100

~ The figure used here includes all farm-gate proceeds of the opium economy (because it is reasonable to assume that these do flow into Afghanistan), but only half of the aggregate profits accruing to Afghan traffickers (because it is not reasonable to assume that all of the "value added" at the processing and trading state enters Afghanistan).

^ These figures are based on World Bank 2001 estimates. It is possible to offer an estimate on the outflow here because the import bill cannot be too much less than the export bill on unofficial trade (a 10% margin on the unofficial re-exports is assumed).

* This figure accounts for the amount of funds transferred by two major UN agencies through the *hawala* system, as verified by the author.

** This figure emerged from interviews with major NGOs operating in Afghanistan.

*** This figure includes regular remittances from migrants and refugees in Pakistan and Iran, and irregular foreign direct investment from the diaspora.

Table 1. Estimates of Afghanistan’s 2004-2005 Aggregate Hawala Flows (From: Thompson)

Hawala, while informal, finances and moves billions of dollars in and out of Afghanistan. It is an impressive feat considering the system relies solely on good business practices and self-regulation among its *hawaladars*.

3. Afghan-Specific Hawala Traits

Aside from the fact that *hawala* in many cases is the only choice available in Afghanistan, like in other regions, it also maintains its appeal as an extremely fast,

⁸¹ Thompson, 160.

⁸² Ibid., 160.

reliable, and affordable means to conduct a financial remittance or transaction. International transfers from Kabul to major financial centers such as London, Peshawar, New York, or Dubai typically only take six to twelve hours. This time can be reduced if *hawaladars* are standing by to receive the money the instant it is sent or ordered.⁸³ Another universal attribute of *hawala* clearly evident in Afghanistan is its affordability. Typical costs for a *hawala* transaction in Afghanistan or neighboring regions is one to two percent.⁸⁴ Coupled with the speed and absence of alternatives, *hawala* has long been the method of choice for money service needs in Afghanistan.

4. Hawala Myths

One of the more populated myths in the barrage of post 9/11 hysteria and media scrutiny of *hawala* is the reported fact that *hawala* transactions are paperless, with *hawaladars* keeping little if any record of transactions, or certainly not beyond the time frame for that transaction to be completed and all funds received by all parties involved. Contrary to conventional wisdom, *hawaladars*' record-keeping and accounting activities appear amazingly robust and professional. *Hawaladars* are careful to take note of currencies traded, international pricing of currencies, deposit balances, debit and credit balances of partner dealers and all customers, all lending transactions, cash on hand, all foreign exchange positions, and customer receipts.⁸⁵ Though only anecdotal, one investigator offered further evidence of the meticulous record-keeping when he noted that after striking a rapport with a *hawaladar* in the Kabul Exchange, the dealer opened his books to show detailed records of every transaction for the past 20 years.

⁸³ Maimbo (2003), 5.

⁸⁴ Ibid., 5.

⁸⁵ Amit Sharma, Remarks given at the Naval Postgraduate School July 31, 2007. Sharma works for the Department of Treasury as the Senior Advisor to the Deputy Secretary of the Treasury and has previously conducted analysis of *hawala* while working in the Office of Terrorism and Financial Intelligence.

Maimbo confirms the findings of the TFI investigator:

The study found that some dealers maintain detailed records for each *hawala* transaction for purposes of remittance and settlement. Dealers know exactly how much cash they have, how much has been transferred, and how much is owed them. During the research, the money exchange dealers routinely provided the following documents in varying combinations: *hawala* slips, customer identification documents and records, and accounting records.⁸⁶

Thompson, too, contradicts the widespread belief that *hawala* is a paperless system. “Access to financial records reveals that that each transaction is carefully logged, and follows its own accounting procedures.” She continues to explain that “one *hawaladar* confided that he documents all of the shop’s drug-related financial transfers on his son’s computer at home.”

This last point is interesting on two accounts. First, it reaffirms the position of this thesis that *hawala* is not paperless, and in fact, *hawaladars* keep meticulous records over long periods of time. They follow normal good business accounting principles. Secondly, and most interestingly, one might infer that if a *hawaladar* keeps such detailed and comprehensive records so as to even have records of transactions involving drug money, it certainly seems plausible, though perhaps academically unverifiable, that *hawaladars* might keep similar records on transactions that they know involve terrorist funds or money designated for insurgent operations. It provides an interesting research question worthy of further investigation by others with more funding and time for field research than is afforded this author. But given that the vast percentage of the Afghanistan’s market is informal, or in *hawala*, it seems likely that some percentage of the volume, though perhaps not as much as the drug volume in *hawala*, is terrorist-related. There may be records kept on these transactions, though they are probably handled even more discreetly than drug transactions on a home computer.

⁸⁶ Maimbo (2003), 7.

5. International Organizations⁸⁷

Due to the lack of formal financial institutions and the unreliability of those in place, *hawala* was during the war-torn Taliban years as it is today, the favorite method of delivery of funds for international aid organizations and non-governmental organizations (NGOs). The formal sector provides little options, and aside from carrying small sums of cash for basic operating costs, international organizations are forced to use *hawala* to send more substantial amounts of money. It is the only viable option.⁸⁸ Under the Taliban, international users had one or two designated *hawaladars* that they could deal with, but now, there is great competition between many *hawaladars* offering more competitive, cheaper, and highly reliable financial services into and out of Afghanistan.⁸⁹ As of 2003, there were 127 international and 467 local NGOs operating in Afghanistan. It is estimated that in excess of U.S. \$200 million was sent through the *hawala* system in the first year after the Taliban government collapsed. Furthermore, in the more rural areas where much of the aid money is desperately needed there is literally no alternative.⁹⁰ Banks are completely absent. There are some formal banks that solicit business from NGOs, but the turn-off for NGOs and *hawaladars* that have to deal with them is that they are “laboriously slow.”⁹¹ Ultimately, the premium advantage of *hawala* over any formal financial entity is its long-stretch (it can reach the most rural areas of Afghanistan) and the fact that it “provides NGOs with liquidity they otherwise might not have.”⁹²

⁸⁷ For a more detailed description and examples of typical NGO/international aid organization transactions through *hawala*, see Maimbo’s 2003 study full report.

⁸⁸ Maimbo, 11.

⁸⁹ Ibid., 11.

⁹⁰ Ibid., 13.

⁹¹ Ibid., 13.

⁹² Ibid., 13.

D. THE AFGHAN FORMAL FINANCIAL SECTOR

1. Mapping the Formal Financial Sector

Afghanistan's formal financial sector reflects a weak history. During the Taliban's rule, only six licensed banks existed providing no commercial services nor did they have the ability to facilitate international remittances.⁹³ Since the fall of the Taliban regime, more formal financial institutions are forming in Afghanistan, but are still lacking in most facets of service. "Like everything else in Afghanistan, the formal financial services are underdeveloped."⁹⁴ As of October 2005, there were 13 licensed banks open for business in Kabul.⁹⁵ New banks such as National Bank of Pakistan, Habib Bank, and Punjab National Bank of India are all conducting business in Afghanistan now. Despite the slow emergence of major international and regional banks, the banking system "is best described as embryonic."⁹⁶ Years of conflict decimated the functionality of Afghanistan's formal banking services.

Because of the war, the financial sector came to an almost complete standstill. The country's banks survived the period in name only but were not functioning at all. It was only the central bank that was able to carry out limited commercial banking operations,' says Noorullah Delawari, governor of Da Afghanistan Bank, the central bank.⁹⁷

Despite the slowly increasing number of services and banks available, the overall effect of the financial sector at the moment is limited in its reach. For one, what little improvement in capacity or availability of service there is in Afghanistan is really

⁹³ Samuel M. Maimbo, "The Challenges of Regulating and Supervising the Hawaladars of Kabul," in *Rural Finance in Afghanistan: The Challenge of the Opium Economy: Report on a Two-Day Workshop, Kabul, Afghanistan, December 13-14, 2004*, (Washington, D.C.: World Bank, 2005), 54.

⁹⁴ "Everything to Play For," *Foreign Direct Investment Magazine*, June 07, 2005. http://www.fdimagazine.com/news/printpage/php/aid/1288/Everything_to_play_for.html (accessed April 3, 2007).

⁹⁵ Thompson, 157.

⁹⁶ *Foreign Direct Investment*, 2005.

⁹⁷ Ibid.

restricted to Kabul. Regional and provincial access to formal financial services is not readily available if at all. Secondly, even in Kabul, practical access for the layman is problematic.

To use an ATM at Afghanistan's leading foreign bank requires you to run the gauntlet of a street known as Sniper Alley, then be patted down by a bristling security detail of Gurkhas before getting access to a cash machine that might or might not be functioning.⁹⁸

It is encouraging that reputable banks are opening shop in Afghanistan, but the reality on the streets of Kabul and throughout the countryside suggest that the formal financial sector is indeed infantile, and still given only granted a cursory look by most Afghans. Essentially, Afghanistan's formal financial sector is not engaged in any meaningful way in rural finance. Afghanistan's formal banking sector is immature and will take years to build. However, many incremental reforms of the formal financial sector are underway.

2. Government Reform and Growth

To gain perspective on Afghanistan's *hawala* system, one must understand the state of the formal financial sector, its reform efforts, and its interplay with *hawala*. Because of its non-existence or dysfunctional nature under the Taliban and the past decades of conflict, Afghanistan's financial sector is being revamped from the ground up.⁹⁹ Financial reform must start from scratch. The biggest critique from policy analysts remains the inadequacy of services provided by Afghanistan's banks. While improving the capacity to offer Afghans meaningful alternative mechanisms to *hawala* will take time¹⁰⁰ other recommendations made by Maimbo have been enacted. Maimbo suggested

⁹⁸Eric Ellis, "Afghanistan Gets Back to Business," *E-Ariana* (September 6, 2006), <http://www.e-ariana.com/ariana/ariana.nsf/> (Accessed April 2007).

⁹⁹ Ibid.

¹⁰⁰ It will take time to put in place substantive alternative financial services and mechanism to *hawala*. However, the physical capacity to offer alternative financial mechanisms or services to Afghans does not in any way suggest that it will necessarily lure Afghans away from *hawala* which is culturally much preferred and seen as much more Islamic in nature and character.

in 2003 that Afghanistan bring in regionally reputable banks with ties to South Asian financial networks. Afghanistan has done this, with several banks of repute from India, Pakistan and elsewhere opening branches in Afghanistan.¹⁰¹ Other foreign banks are from the UK, Tajikistan, and Iran.¹⁰²

While the preceding section paints a bleak picture, there is measurable, though small progress. “Compared with conditions in December 2001- an outdated legal framework, no functioning commercial banks, a handful of NGOs competing with a vibrant informal financial sector- a basic formal financial system has emerged.”¹⁰³ The government of Afghanistan has worked feverishly to empower Da Afghanistan Bank by enacting several laws giving DAB greater autonomy. More branches are electronically connected, a basic monetary policy is emerging, including the emergence of a new currency, and by and large the ability of DAB to function in practical ways for its customers has improved.¹⁰⁴

Despite its limited services, the slow but upward trajectory of the Central Bank (DAB) makes it a relatively successful story in Afghanistan. The bank is run by Noorullah Delawari, a successful commercial banker from Southern California who returned to his native country in 2002 with a strong desire to improve it.¹⁰⁵ As Delawari boasts, “We have come a long way in a short time.”¹⁰⁶ When the Taliban fled in December 2001 they raided the vaults of DAB leaving behind a skeleton of a bank. In Delawari’s first 18 months as governor of the central bank, he helped grow its assets to U.S. \$2 billion. Perhaps his most successful reform alluded to earlier was his push for legislation in 2003 that ultimately replaced four competing currencies with one currency.¹⁰⁷

101 *Foreign Direct Investment*, 2005.

102 Ellis.

103 Maimbo (2005), 56-57.

104 *Ibid.*, 57.

105 Ellis.

106 *Ibid.*

107 *Ibid.*

Other positive signs of reform and growth are in the amount of money being handled by the new banks emerging in Afghanistan's financial landscape. UK's Standard Chartered handles roughly 70% of the U.S. \$3-4 billion in annual aid inflow. Also, local banks such as the ING-backed Afghanistan International Bank, Azizi Bank and Kabulbank have taken in excess of \$350 million in deposits.¹⁰⁸

The most 'outside the box' thinking and formal sector financial innovation is found in the Kabulbank. Kabulbank is a three-year old joint venture with partners from the same Afghan *hawala* network that is seen as the source of so much terrorist financing by the U.S. government. It is owned by a conglomerate of *hawaladars* who became rich operating within Afghanistan's informal *hawala* system.¹⁰⁹ Kabulbank has used eccentric and radical concepts of advertising and operations to lure customers. The biggest draw is basically a national lottery. There are semantic differences and legalistic nuances in its strict form so as to technically not be a lottery, but in effect, that is exactly what it is. Kabulbank has used this approach to gain widespread acclaim in Afghanistan. By all accounts, Kabulbank has been an amazing success story, collecting more than \$200 million in deposits in its first two years of business.¹¹⁰

The center of the excitement surrounding Kabulbank is the *Bakht* deposit account launched in April 2006. In Dari *bakht* means "fortune." Kabulbank has capitalized on this cultural meaning with its chief advertising slogan that proclaims the Kabulbank *Bakht* initiative is "the easiest way to make a million."¹¹¹ *Bakht* has had a profound effect on Kabulbank's growth. Since *Bakht's* inception, Kabulbank's customer base has tripled, making it the largest of the 13 licensed commercial banks in Afghanistan operating since the beginning of Operation Enduring Freedom.¹¹² The concept is simple. Every U.S. \$100 deposited in the *Bakht* account (about Af\$5000) entitles the depositor to a ticket for a drawing. Monthly, Kabulbank conducts the *Bakht* lucky draw and televises it across Afghanistan. The bank trumps up the grand event in a grand hall and uses

¹⁰⁸ Ellis.

¹⁰⁹ Ibid.

¹¹⁰ Ibid.

¹¹¹ Ibid.

¹¹² Ibid.

Afghan celebrities, political figures and other notables to pull the winning ticket. The winner's name is read aloud and if present, he is presented a check for Af \$1 million.¹¹³ This is a lifetime fortune for any Afghan.

Working around the tenets of Islam has been a semantic challenge, but Kabulbank has made it work. Ellis explains:

Gambling is banned in Islam and Kabulbank's Bakht line differs crucially from a conventional lottery since the ticket holders, the depositors, keep their stake even if they don't win the monthly draw for the Af1 million, a lifetime's income or most of Afghanistan's 30 million people. Indeed, they remain eligible for the next draw, and those after that, with more chance available every time they deposit units of Af \$5,000. Although such a product wouldn't pass the test of the Federal Reserve or the Bank of England- and it has disquieted mandarins at Kabul's central bank, which changed its bank monitoring team three time- it's a dubious stroke of marketing genius from the bank's point of view.¹¹⁴

Delawari has led some of the most important formal sector reforms geared at curbing illicit or terrorist financial abuses in the Afghanistan economic system. His most personally touted achievement is the creation of his bank's surveillance division. Johnson Rappai, the CEO of Kabulbank, fully backs the leadership of the central bank and its mantra for curbing illicit abuse of the formal sector:

'You can't just open an account here,' Johnson says. 'All identity should be made available- your passport, your ID, your trade license. Yes, people can tell lies or have forged documents but we make every effort to establish bona fides, we cross-check it when the money comes. We ask you from where you got this one million dollars.'¹¹⁵

Also, with the help of the U.S. Treasury Department, Delawari has set up a Financial Intelligence Unit at the central bank (DAB) with a full complement of U.S. Treasury

¹¹³ Ellis.

¹¹⁴ Ibid.

¹¹⁵ Ibid.

advisers in order to help monitor suspicious activity.¹¹⁶ Delawari and DAB have made great strides to follow best business practices and thoroughly know their customers to the extent possible. The creation of the FIU may not be all encompassing, but it is a step in the right direction to at least understand and map who is using Afghanistan's financial institutions and for what purposes.

The central bank has pursued reform through other methods as well. Bearing Point, a leading worldwide financial management and technology consulting company, is also serving the Afghan central bank in establishing sound economic and financial sector reform.¹¹⁷ Other outside the box financial initiatives include project financing for the agricultural sector and venture capital funds emphasizing investments that can capitalize on Afghanistan high risk, but equally high reward environment.¹¹⁸

Micro-financing is another innovative reform method in play in Afghanistan. "Microfinance is understood to mean the provision of banking (savings, credit, payment transfers) and insurance services for low income people, especially the poor, and is provided by a wide range of regulated financial institutions as well as NGOs."¹¹⁹ The goal of the microfinance movement is to narrow the gap between services available for the few through the big financial institutions and the rural inhabitants of Afghanistan. Somewhere in the middle hopefully a system will take shape that promotes both "mainstream financial development and institutions that focus on offering the poor direct access to financial services."¹²⁰ In essence, microfinance reform is attempting to create financial service products and mechanism that more fully meet the needs of the poor than the formal sector mechanisms do.

¹¹⁶ Ellis.

¹¹⁷ *Foreign Direct Investment*.

¹¹⁸ Ibid.

¹¹⁹ Steve Rasmussen, "The Current Situation of Rural Finance in Afghanistan," in *Rural Finance in Afghanistan: The Challenge of the Opium Economy: Report on a Two-Day Workshop, Kabul, Afghanistan, December 13-14, 2004*, (Washington, D.C.: World Bank, 2005), 23.

¹²⁰ Ibid., 23.

3. New Laws

Working with the U.S. Treasury Department, international financial experts, and others, Afghanistan has put in place a number of laws explicitly aimed at curbing terrorist and other illicit financial transactions by criminalizing them. In Article 1 of the Islamic Republic of Afghanistan's Anti-money Laundering and Proceeds of Crime Law, the purpose of the law is articulated clearly. The purpose is to "prevent and prohibit the use of financial institutions or any economic activities for money laundering and for the financing of terrorism."¹²¹ The law carefully defines money-laundering, details what individuals and institutions are subject to the law, creates provisions for greater transparency in financial transactions, prohibits anonymous accounts and transfers, establishes rules for amounts of cash that can cross its borders, sets trip-wire mechanisms for series of transactions meant to circumvent regulatory limits, provides for special monitoring of "unusual" transactions, outlines good banking practices for institutions, outlines how to keep detailed records, provides reporting requirements for suspicious transactions, and most prominently, established the Financial Intelligence Unit under the authority of Da Afghanistan Bank. The FIU is granted by law with independent decision-making authority in how it exercises the provisions of the law. Additionally, this law grants the government and DAB great leeway to seize suspect fund and illicit accounts.

Afghanistan also created the Afghanistan Law on Combating the Financing of Terrorism. This law further defines what constitutes an offense of financing terror. It also delineates the government's rights to confiscate, freeze, and hold property and funds alleged to have been used in the act of terrorism or through terror financing. This law provides a general umbrella for more specific laws to follow.

Pursuant to Article 77 of the DAB Law, DAB outlines more specific regulations and rules for hawaladars. The Foreign Exchange Dealer Law decrees that an applicant "must file an application acceptable to DAB to act as a foreign exchange dealer..." and that "no person may act as a foreign exchange dealer unless he holds a license issued by DAB."

¹²¹ Islamic Republic of Afghanistan Anti-money laundering and Proceeds of Crime Law, 2004, <http://www.centralbank.gov.af/laws®ulations-dab.asp> (accessed June 2007).

In order to be eligible for the license, a person must:

1. be at least 18 years old
2. be the owner of a personal property such as a house or apartment;
3. take a license in the name of a single person, with the license valid at a single locations of a business or multiple locations within the same province;
4. Be referenced by two business persons with at least three years of commercial experience;
5. Provide a national taxpayer identification number.¹²²

Other requirements include: the name, permanent address; and place of birth of the dealer; copy of the applicant's national identification card; a photograph of the dealer; details of the dealer's financial history; a list of who the dealer plans on doing business with; a copy of his tax payer identification number (TIN) certificate; any previous licenses; tax certification; certification from the Interior Ministry of the Criminal Department; receipt of licensing fee payment from DAB; and receipt of licensing deposit from DAB.¹²³ Additionally, the law mandates quarterly reporting to the DAB and the strictest cooperation and transparency of its transactions with the government.

The Money Service Providers' Law has similarly stringent provisions. Applicants must demonstrate their fitness for trust by the state, have an established address for business, agree to the tenets of the Anti-Terrorism Law detailed previously, and agree to a DAB "Money Service Providers Licensing Agreement." Money Service Providers may engage in money transmission, safekeeping of funds, and check cashing, but are prohibited from using other than DAB's official record books for recording customer and transaction information, acceptance of deposits, foreign exchange transactions, granting of loans, including terminology indicative of any other services provided other than "money service provider" in the title of the business, payment system operations as

¹²² DAB Foreign Exchange Dealer Law, <http://www.centralbank.gov.af/laws®ulations-dab.asp> (accessed June 2007) .

¹²³ Ibid.

enumerated in Article 89 of the Law of DAB, security services enumerated in Article 94 of the Law of DAB, or securities transfer systems enumerated in Article 98 of the Law of DAB.¹²⁴

4. Hawala Interaction with the Formal Sector

In contrast to its eastern neighbors, Afghan *hawaladars* have limited contact with the formal financial sector.¹²⁵ One of the chief reasons for the limited interaction with the formal sector is the physical location. Formal financial institutions are nowhere near the bazaars and markets where Afghan *hawaladars* operate. Due to both the physical limitations of the *hawaladars* and the very real security concerns, the daily visits required of a *hawaladar* to conduct business with formal institutions would be very problematic. As opposed to the close proximity of *hawaladars* and formal banks in Pakistan, “in Kabul, on the other hand, new banks are being established in an area disconnected from the main business districts, making it difficult for the *sarafi*¹²⁶ operating in Sarai Sha Zadar to access them.”¹²⁷ Other than the few instances such as the success of Kabulbank, interaction between the formal and informal sectors of the Afghanistan financial world has been sparse. The obstacles, grievances and historical reasons for this limited interplay will be explored further separately.

E. THE NEXUS OF DRUGS AND HAWALA¹²⁸...AND TERROR?

1. A Problem of Epic Proportions

Afghanistan’s drug problem has reached grand heights. With cooperative weather and perfect harvest conditions, Afghanistan’s opium production increased 17% in 2007. 2007 UN statistics estimate a whopping 8200 tons of opium were produced this past year. In fact, more land is dedicated for opium cultivation in Afghanistan than there is land

¹²⁴ Regulation on Money Service Providers under the Law of DAB, <http://www.centralbank.gov.af/laws®ulations-dab.asp> (accessed June 2007).

¹²⁵ Thompson, 182.

¹²⁶ *Saraf*, or plural, *sarafi*, is the Afghan name that hawaladars often call themselves

¹²⁷ *Ibid.*, 182.

¹²⁸ From Thompson’s title phrase, *The Nexus of Drug Trafficking and Hawala in Afghanistan*.

designated for coca cultivation in Peru, Colombia, and Bolivia combined.¹²⁹ In recent years, Afghanistan has produced an estimated 87% of the world's opium supply.¹³⁰ In 2007, Afghanistan is producing a staggering 93% of the world's opiate market.¹³¹ Afghanistan's opiate production is on an unprecedented scale in the history of mankind.

The bulk of the opiate economy is located in the south-west of Afghanistan. 70% of Afghanistan's entire opiate production is in the five provinces that border Pakistan. In fact, it is estimated that 50% of the state's entire opium originates in one province, Helmand.¹³² Helmand is the richest drug province or state in the world. The 17% increase in opiate cultivation in 2007 raised the production from 165,000 ha in 2006 to 193,000 ha this past year. The net effect was a 17% increase in the total world opiate cultivation!¹³³ In the past few years of conflict and war, Afghanistan has distinguished itself as the unquestioned world leader in narcotics.

¹²⁹ United Nations Office on Drugs and Crime, "Afghanistan Opium Survey 2007: Executive Summary," (New York: United Nations, 2007), iv.

¹³⁰ Johnson DRAFT, 30.

¹³¹ UNODC Executive Summary, iv.

¹³² Ibid., iv.

¹³³ Ibid., 3.

	2006	Difference on 2006	2007
Net opium poppy cultivation	165,000 ha	+17%	193,000 ha
In per cent of agricultural land	3.65%		4.27%
In per cent of global cultivation	82%		82%
Number of provinces affected	28		21
Number of poppy free provinces	6		13
Eradication	15,300 ha	+24%	19,047 ha
Weighted average opium yield	37.0 kg/ha	+15%	42.5 kg/ha
Potential production of opium	6,100 mt	+34%	8,200 mt
In percent of global production	92%		93%
Number of households involved in opium cultivation	448,000	+14%	509,000
Number of persons involved in opium cultivation	2.9 million	+14%	3.3 million
In per cent of total population (23 million)	12.6%		14.3%
Average farm-gate price (weighted by production) of fresh opium at harvest time	US\$ 94/kg	-9%	US\$ 86/kg
Average farm-gate price (weighted by production) of dry opium at harvest time	US\$ 125/kg	-2%	US\$ 122/kg
Afghanistan GDP ¹	US\$ 6.7 billion	+12%	US\$ 7.5 billion
Total farm-gate value of opium production	US\$ 0.76 billion	+32%	US\$ 1 billion
Total farm-gate value of opium in per cent of GDP	11%		13%
Household average yearly gross income from opium of opium poppy growing families	US\$ 1,700	+16%	US\$ 1,965
Per capita gross income of opium poppy growing farmers	US\$ 260	+17%	US\$ 303
Afghanistan GDP per capita	US\$ 290	+7%	US\$ 310
Indicative gross income from opium per ha	US\$ 4,600	+13%	US\$ 5,200
Indicative gross income from wheat per ha	US\$ 530	+3%	US\$ 546

¹ Source: Afghan Government, Central Statistical Office, preliminary estimate.

Table 2. 2007 Afghanistan Opium Estimates. (After: UNODC, Afghanistan Opium Survey 2007 Executive Summary)

2. The Convergence of Poppy Seeds and Bullets

An interesting trend appears in the 2007 UNODC Afghanistan Opium Survey. While the poorer regions remain in northern Afghanistan, opiate production has diminished there. However, opiate cultivation has increased dramatically in the south-west and east of Afghanistan. It should not be lost on anyone that this is the heart of the current insurgency and the provinces plagued by al Qaeda, the Taliban remnants, and other terrorist entities.

This North-South divide highlights three new circumstances. First, opium cultivation in Afghanistan is no longer associated with poverty-quite the opposite. Hilmand, Kandahar and three other opium-producing provinces in the south are the richest and most fertile, in the past the breadbasket of the nation and a main source of earnings. They have now opted for illicit opium on an unprecedented scale (5,744 tons) while the much poorer northern region is abandoning the poppy crops. Second, opium cultivation in Afghanistan is now closely linked to insurgency. The Taliban today control vast swathes of land in Hilmand, Kandahar and along the Pakistani border. By preventing national authorities and international agencies from working, insurgents have allowed greed and corruption to turn orchards, wheat and vegetable fields into poppy fields. Third, the Taliban are again using opium to suit their interests. Between 1996 and 2000, in Taliban-controlled areas 15,000 tons of opium were produced and exported – the regime's sole source of foreign exchange at the time. In July 2000, the Taliban leader, Mullah Omar, argued that opium was against Islam and banned its cultivation (but not its export). In recent months, the Taliban have reversed their position once again and started to extract from the drug economy resources for arms, logistics and militia pay.¹³⁴

Opiate cultivation, production and distribution have become a staple ingredient in the financial planning of terrorists, insurgents, and other jihadists. Thus far, the Karzai regime has proved inept in curbing its preeminence in the Afghan economy.¹³⁵ This is because as big of a problem as the opiate cultivation is, the corruption and greed rampant in his government may be even worse. There is no accountability and everyone from the Taliban to high-level government officials like General Daud, the Interior Minister for Counter Narcotics are rumored to have their hand in the cookie jar.

¹³⁴ UNODC Executive Summary, iv-v.

¹³⁵ Johnson DRAFT, 34.

3. The Dark Triangle: Hawala, Drugs and Terror

“The presence of a burgeoning opium economy and terrorism in Afghanistan provides for considerable risk to the *hawala* system.”¹³⁶ As the insurgency has grown in recent years alongside the booming opium crops, a natural nexus has emerged between drugs and terror. This nexus occurs in the informal *hawala* network that helps conceal the financial movements of both illicit industries. While Thompson provides a lengthy and superb analysis of every region in Afghanistan and its *hawala* connections with the drug economy, pursuant to the goals of this thesis, this section will focus on her analysis of the provinces and regions in the heart of the Pashtun belt. It is the hypothesis of this author that there is a direct correlation between the intensity of terrorist/insurgent activities in certain areas and the intensity of *hawala* drug-related transactions in certain areas that are well-documented by Thompson. It seems very logical that in these areas with intense drug-related *hawala* activity, there might also be intense abuse of the *hawala* networks by insurgents/terrorists. This data is not available, but is deserving of further academic research.

Helmand and Kandahar are located in the heart of Pashtun country that stretches across the border into Pakistan. These provinces are “ideally placed to exploit the extensive Pashtun trading networks that reach many of the world’s key financial sites.” As one *saraf*, or *hawaladar*, described the nature of the relationship between Helmand (or Hilmand) and Kandahar, “you may as well see them as one and the same market.”¹³⁷ The same holds true for the areas on the other side of the border. Just as Helmand and Kandahar are one Pashtun economy with tight interdependence, so are the cross-border economies and social ties with the Pashtuns in Pakistan. It is one network, one economy, and one kindred social viewpoint.

Because of Kandahar’s strategic location in Pashtun country it is “an important site to explore the links between the informal *hawala* networks and the trafficking of drugs.”¹³⁸ This thesis argues that the nexus between drugs and terror makes Kandahar an

¹³⁶ Amit Sharma, Naval Postgraduate School, July 31, 2007.

¹³⁷ Thompson, 170.

¹³⁸ Thompson, 176.

important site to study the correlation between *hawala* and terror, too. If *hawala* is being exploited for the concealed movement of illicit drug funds, it seems reasonable to assume that it is being exploited in a similar fashion and with similar intensity by insurgents and terrorists. Helmand, too, boasts similar pre-conditions for abuse of its *hawala* network.

Examining the UN data juxtaposed with Thompson's survey data, there seems a clear connection between *hawala*, drugs and terror money. Through a representative survey of 10 small, medium and large *hawaladars* in the major markets of Kandahar City and Helmand, Thompson estimates there are a median 54 *hawaladars* who specialize in drug transactions. "There was considerable unanimity among medium-large dealers when asked to estimate the percentage of *hawaladars* indirectly involved in drug money laundering. Helmand dealers estimated that 80-85% dealt in drug funds, while Kandahar dealers estimated that 90% handled drug money."¹³⁹ While further academic investigation is warranted, it seems likely there is a similar cadre of *hawaladars*, maybe some of the same *sarafi*, who specialize in terror leg of the black triangle. Thompson does not map out this area of the Afghanistan *hawala* network, but provides solid basis for further investigation. Sharma, a Treasury Department official who has spent time in Afghanistan investigating the *hawala* system and financial reform there, offers this conclusion:

The broad answer is, yes folks (*hawaladars*) agreed that they did 'know' their customers, and therefore did indeed know much of the time what the business they were facilitating included... that said, everyone I spoke with did admit that facilitating terror (and other illicit activity for that matter) was not a good thing, and that they did want to find solutions that they could shove out this business but do so in a way that still retained their access to the larger pool of funds and the market.... I do think there is a distinction drawn between facilitating narcotics and terrorism – absolutely – and we need to remember that financially facilitating some of the drug trade is interpreted different ways... especially if some count their livelihood that way.¹⁴⁰

¹³⁹ Thompson, 177.

¹⁴⁰ Amit Sharma, Email message to the author, November 1, 2007.

Province and city	No of sarafs specialising in drug monetary transfers
Helmand - Lashkar Gar	14
Helmand - Sangin district	15
Kandahar - Kandahar city	25
Total:	54

Table 3. Drug-Specialist Hawaladars in Southern Afghanistan (After: Thompson)

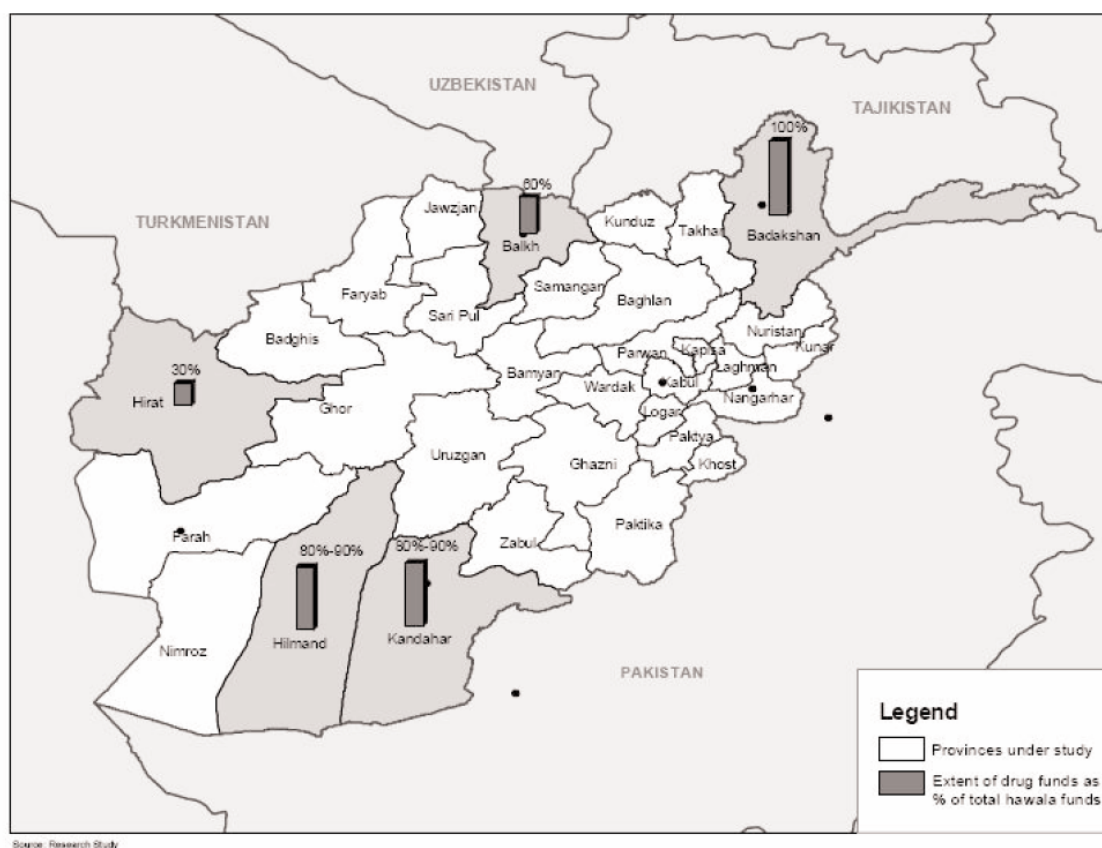


Figure 3. Percentage of Drug-Related Hawala Transactions. (From: Thompson)¹⁴¹

¹⁴¹ Thompson, 156.

The nexus between drugs and *hawala* is palpable. The more difficult connection is the third leg of the black triangle: terror. Accepting Thompson's data as fact, or as close to fact as one can get in the inherently reclusive and informal *hawala* network of Afghanistan, one must next examine the interplay of terror in *hawala*. The UN data shows the richest poppy cultivation in the volatile southern provinces of Helmand and Kandahar, as well as a few eastern and north-eastern provinces. The connection between drugs and terror, and implicitly *hawala*, come into focus in U.S. Central Command's data on 2006 coalition forces attacks during the months leading up to harvest in the aforementioned drug provinces. Insurgent and terrorist activities in Helmand, Kandahar and the eastern, northeastern provinces are highest during the peak drug months of early 2006. There seems an obvious direct connection between the two, and likewise, given the exposed abuse by drug-specialist *hawaladars* in these provinces and the researched data showing extremely high percentages of overall *hawala* drug-related activity in Helmand and Kandahar, an equally apparent connection of the two with *hawala*. It is unlikely that there are as many actors involved either as terror *hawaladars* or terrorist/insurgents actors in general due to the nature of terrorism and its high risk and low financial reward. Still, even if the number of *hawaladars* involved is fewer, there is a high probability of correlation to the intensity of *hawala* drug transactions in Afghanistan's volatile southern provinces.

The drug and terror networks are more duplicitous than imagined. They appear to be one convergent network with tactical differences but complimentary strategic outlooks. In many cases, they may be exactly the same. Certainly, it appears probable that the *hawaladars* that service both the drug and terror industries are the same, though further field research is desired to verify this hypothesis. It is reasonable to assume that a *hawaladar* that bears the risk of dealing with drugs might also be tempted by the allure terror financing. It is probably more certain that *hawaladars* that deal with terrorist transactions initially also deal with drugs if given the opportunity. The final bit of mud in the water is the rich Pashtun interdependence that sweeps into Pakistan provides policymakers and regulators with a difficult context in which to begin deciphering the tightly woven nexus of Afghanistan's black triangle.



Figure 4. 2006 Opium Poppy Cultivation. (After: United Nations)

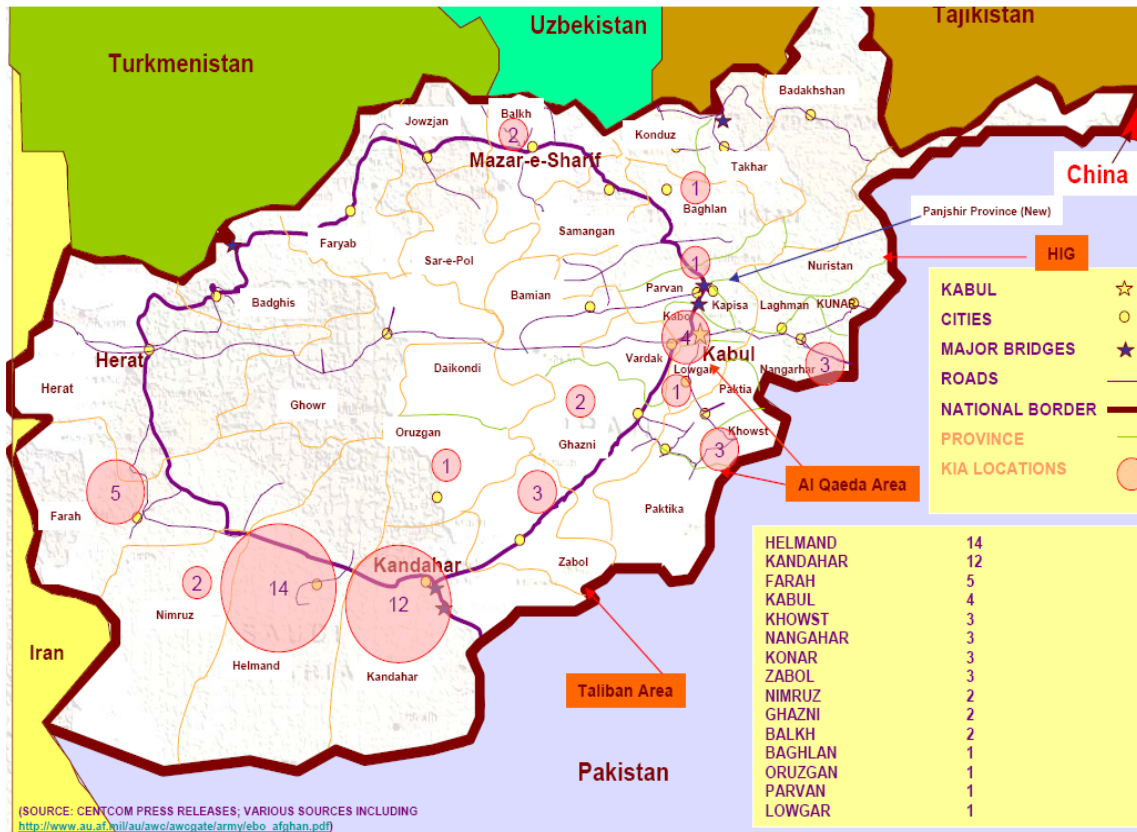


Figure 5. OEF Attacks on Coalition Forces February 2006. (From: CENTCOM and Thomas Johnson)

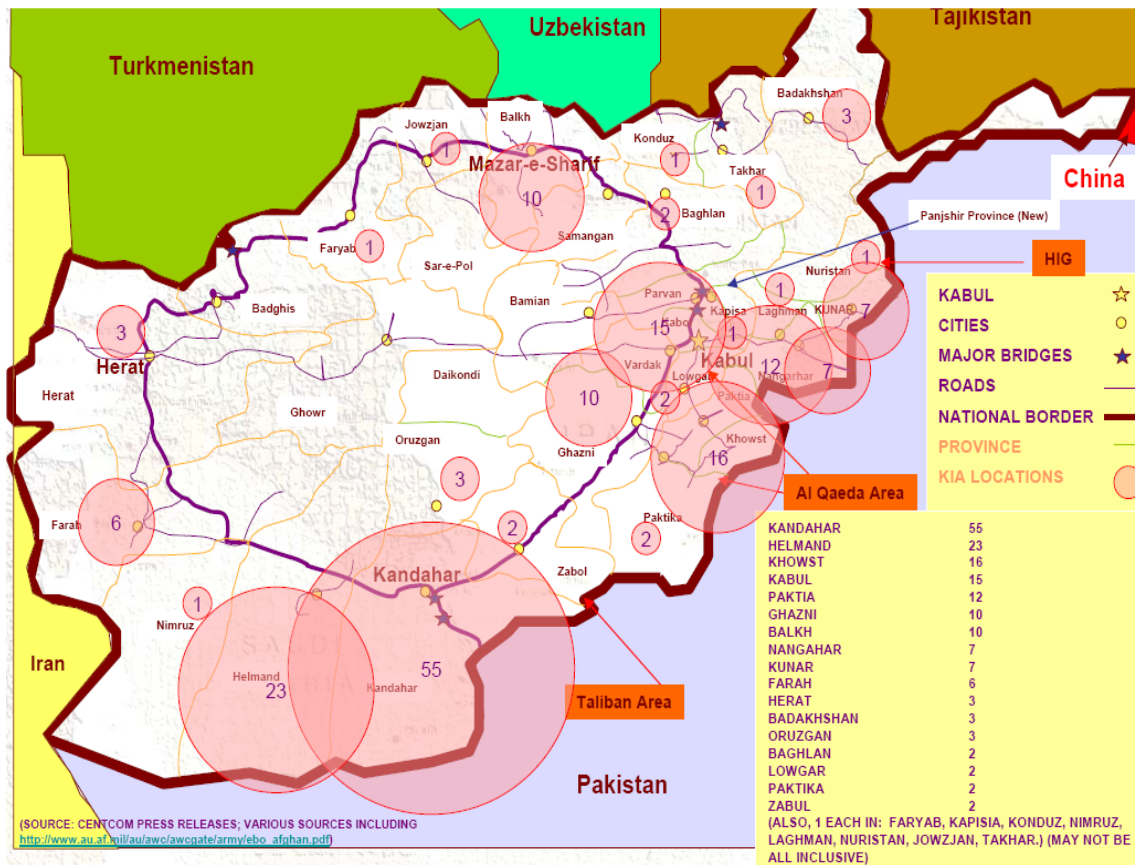


Figure 6. OEF Attacks on Coalition Forces March 2006. (From: CENTCOM and Thomas Johnson)

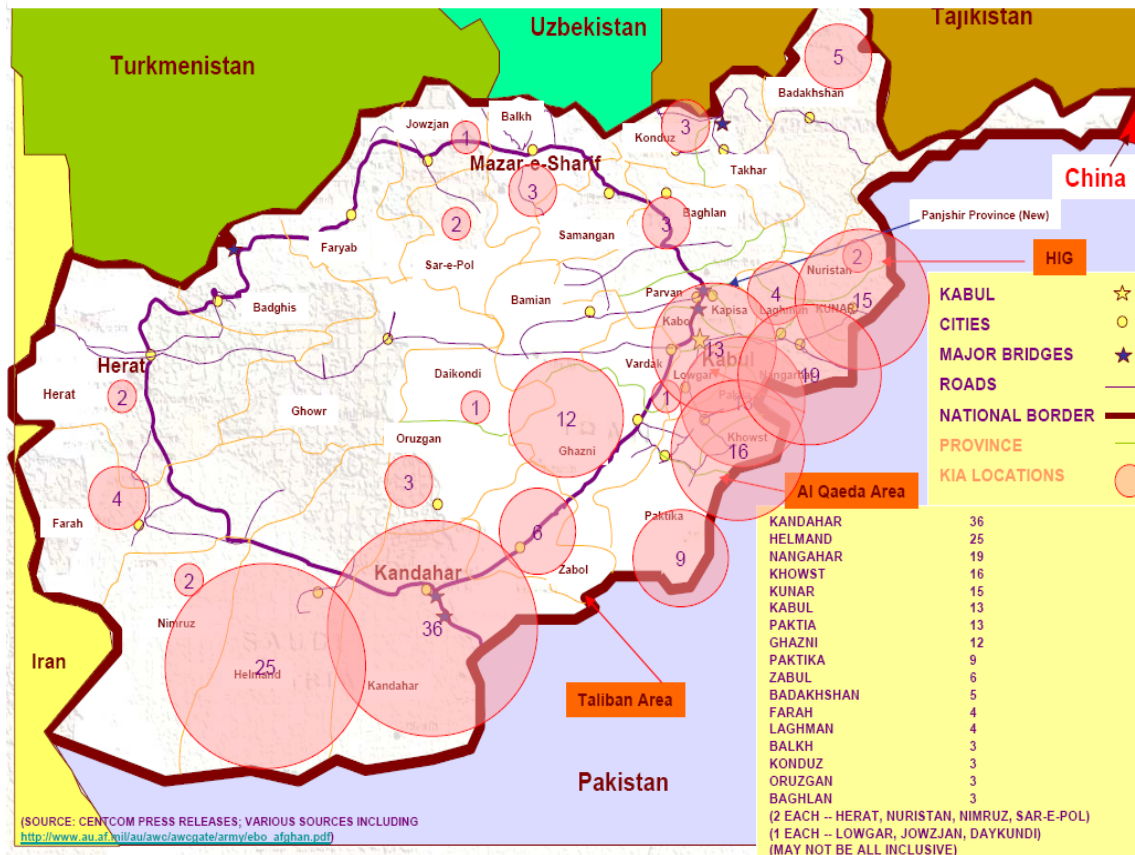


Figure 7. OEF Coalition Attacks April 2006. (From: CENTCOM and Thomas Johnson)

F. REGULATORY AND REFORM MODELS: THE WAY FORWARD

1. Current Models

In the wake of the events of September 11, 2001, and the subsequent international efforts to combat money laundering and the financing of terrorism, abstaining from regulation or supervision of the informal financial system is no longer a tenable option.¹⁴²

Given the intense interest and focus on the *hawala* system of the Middle East and Islamic world post 9/11, some measure of oversight or regulation is required. One can make a strong case that no regulation is needed whatsoever, but given the political

¹⁴² Maimbo (2003), 16.

climate, such a position is politically unsustainable. Within this framework several regulatory models are on the table, several have been enacted at the behest of the U.S. government and international coalition, and others have suggested strategic guidelines that map out best practices to maximize the benefit of *hawala* while curbing the illicit components. The most critical aspect of any regulation, though, must consider the unique characteristics of Afghanistan's financial system and people. *Hawala* in the U.A.E. is not *hawala* in Pakistan. *Hawala* in Pakistan is not *hawala* in Afghanistan. *Hawala* in Afghanistan is not *hawala* in the U.A.E.. Blunt regulatory tools¹⁴³ and policy cannot be universally applied to the many people who utilize *hawala*. It is culturally ignorant to do so, and unrealistic to expect the people of Afghanistan to wrap their arms around a policy better suited for Pakistan or maybe Indonesia.

In Maimbo's field research, many *hawaladars* in fact did make passionate arguments against any regulation. Four main points emerged in this argument: First, *hawaladars* are difficult to identify for regulation. Some are only *hawaladars*, but others operate as *hawaladars* in addition to being a butcher, or running a market store. Second, there is no incentive to open themselves up as a business community to external regulation. *Hawaladars* fear the big stick approach shown by regulators in the al Barakaat debacle in Somalia. Third, *hawala* transactions are varied and would be difficult to develop a regulatory pattern for. Lastly, even if sound regulations were feasible, DAB absolutely lacks the capacity to enforce anything.¹⁴⁴ For the *hawaladars*, regulation appears wrought with danger and low in reward. From the government perspective, Afghanistan needs to focus its immediate attention elsewhere first.

Afghanistan's central bank faces several basic but fundamental challenges-all of which makes the matter of regulating the *hawaladars* less urgent by comparison...Even when compared with other conflict-afflicted countries, Afghanistan's authorities face great challenges.¹⁴⁵

¹⁴³ Specifics of U.S. regulatory policy and the FATF special recommendations on terror financing are discussed in-depth in a separate chapter.

¹⁴⁴ Maimbo (2003), 16.

¹⁴⁵ Maimbo, 16-17.

What does work in Afghanistan is self-regulation. The *hawaladars* of Kabul have been self-regulating without any oversight since 1930.¹⁴⁶ There are over 300 self-regulating *hawaladars* in the Kabul Money Exchange. The Kabul *hawaladars* even serve under an executive committee “responsible for enforcing the tacit rules and business codes of the market; code violations bring serious consequences. The executive committee is also responsible for the amicable settlement of disputes.”¹⁴⁷ Self-regulation is a viable option because the *hawaladars* are better able to identify the problems within *hawala* and deal with them more effectively than any external regulators every could. Even *hawaladar* input was solicited in the right way, *hawaladars* might have a more vested interest in the rules and regulations imposed (since they created them) and this might narrow the gap between the formal financial world (and government) and the *hawala* system.¹⁴⁸ Self-regulation allows for a more realistic approach to effective regulation than that from the FATF or central bank which is largely seen as meddling or external interference in legitimate business.

Another option on the table is a hybrid model aimed at creating transparency without sacrificing the allure of *hawala*’s inexpensiveness, efficiency, and reach. In an incremental process, carefully choreographed with the help of the *hawaladars* themselves, *hawaladars* would be asked to register (not licensed), identify customers carefully to include physical address, bear the responsibility of suspicious activity reports, and when necessary, facilitate investigations.¹⁴⁹

2. Challenges to Reform

Hawala is ingrained in the cultural and religious landscape of Afghanistan. It is part of daily life. “The market has such a long history of operational and regulatory independence that external oversight is unlikely to be easily welcomed- especially if it is overly burdensome.”¹⁵⁰ Afghanistan, a state plagued by *the great game* and other

¹⁴⁶ Maimbo (2005), 57.

¹⁴⁷ Maimbo (2003), 17.

¹⁴⁸ Ibid., 17.

¹⁴⁹ Ibid., 17.

¹⁵⁰ Maimbo (2005), 58.

imperial interferences does not want external or western policies forced on them. This is the first challenge. Afghans simply prefer *hawala*. It is a subtle but important point; this is what the people *want*. While not exclusive to Muslims, *hawala* is sanctioned by *sharia* law and is synonymous with Islamic banking. It is a cultural aspect of Islam that can be traced back to the Prophet Mohammed, himself a trader and user of the informal economy.

Literacy is another impediment to *hawala* reform or acceptance of regulation. Broad FATF regulations not adapted to Afghanistan miss the mark and alienate the population. 74% of Afghans and 91% of women are illiterate and most have no formal identification.¹⁵¹ This social condition is a disabling pre-text for the transfer of *hawala* informal economy to the formal sector. It is unrealistic and ignorant to expect Afghans to embrace rules better suited for a U.S. state. Western corporate procedures and business plans, formal accounting, and other reform ideas that are being incorporated by U.S.AID (United States Agency for International Development) and the World Bank are unlikely to succeed given the underlying illiteracy problem in Afghanistan. Delawari is pushing universities to offer courses on business, accounting, and financial literacy¹⁵², but this is a long-term problem with a slow process toward improvement. In the meanwhile, it is a huge obstacle to reform.

Perhaps the most glaring error in policy and hindrance to *hawala* regulation or reform is the lack of input received from *hawaladars*, or rather the lack soliciting of *hawaladars* by policy makers. Every expert from Wilson to Thompson to Passas to Maimbo has suggested what is plain to see; the first step in any serious discussion of moving forward should be to co-opt the *hawaladars* of Afghanistan, namely the executive committee of Kabul's market. Yet, six years after 9/11, this has not genuinely happened. Talk is cheap. While the U.S. Treasury Department and the DAB will almost certainly say that *hawaladars* have been engaged in the reform process, including the most recent round of laws concerning money-dealers and foreign exchange dealers,

¹⁵¹ Thompson, 186.

¹⁵² Ellis.

research shows this engagement to be skin-deep. Commenting on the Treasury Department's own mission to Kabul in 2004, this conclusion was reached:

Several hawala dealers commented on the fact that while the DAB had several open forums for discussion on the issuance of new regulations, the forums provided only limited opportunity for the engagement of the sector on the establishment of those regulations since DAB had substantially determined the nature of the regulations themselves prior to the forums, and in any case, only a few of the Kabul based dealers attended. As a result, incentives for compliance are not built into the legal framework nor supported by credible enforcement. Therefore, there has been little to no cooperation with regard to the development and implementation of the present regulatory and supervisory framework or compliance.¹⁵³

Whether or not it is reality, the perception among *hawaladars* is certainly one of alienation and exclusion from the reform process by the government.

Hawaladars have a preset suspicion of authority. "Collaboration with government regulators requires a profound social and psychological stretch for those who run the networks."¹⁵⁴ The mistrust of the formal sector and government regulation creates an inherent problem.

Hawaladars view law enforcement agencies with suspicion and often contempt. Unlike other informal sector enterprises, such as the drug trade where there are close alliances with elements of the police, *hawaladars* have an adversarial relationship with law enforcement and view them as a major source of corruption and theft.¹⁵⁵

There is no strong inclination for *hawaladars* to emerge from the shadows, much less be dragged out by their feet.

Finally, *hawaladars* acknowledge that there are certainly illicit funds facilitated through their *hawala* system. However, as individual *hawaladars*, they would not stem

¹⁵³ Amit Sharma, Naval Postgraduate School, July 31, 2007.

¹⁵⁴ Thomas A. Timberg, "Informal Remittance Systems and Afghanistan," <http://www.nathaninc.com/NATHAN/files/CCPAGECONTENT/DOCFILENAME/0000502422/Informal%20Remittance%20Systems%20and%20Afghanistan.pdf> (accessed May 2007), 7.

¹⁵⁵ Thompson, 169.

the flow.¹⁵⁶ There is too much at stake. In a business environment run on honor, interdependent peer relationships, and tacit rules, one cannot venture off the beaten path without consent. The risk of being black-listed or cut out of the business partnerships required to conduct transactions is too great. There is great fear among *hawaladars* that cooperation in driving out illicit funds would be disclosed (back to the issue of general mistrust of the central government) and financially ruin their own business due to the interdependent nature of *hawala*.

G. THE HAWALA THREAT: PRIMARY VARIABLES IN AFGHANISTAN THAT WARRANT ANALYSIS IN OTHER CASE STUDIES

In examining Afghanistan's *hawala* system and whether it is a strategic threat to U.S. counter-terror efforts, four variables should be given primary consideration. Afghanistan exhibits these four factors in varying degrees and emphasis. Three factors present in Afghanistan's *hawala* system indicate benign uses for *hawala* that should reassure U.S. financial investigators and intelligence agencies when examining other cases such as Pakistan and U.A.E. The last variable predominant in Afghanistan offers a point of analysis that is a presumable indicator of illicit abuse. This last variable may still not be a strategic threat, but is assuredly some level of threat and the most likely arena in which *hawala* will be subject to unbridled abuse. These important variables should be the first points of focus in other case studies that assess *hawala's* complicity with terrorist financing and its strategic threat to the U.S..

First, one must consider the Islamic aspect of *hawala*. If the community, state, or population under analysis is predominantly Muslim, because of the strong cultural place *hawala* holds within Islamic society, in that particular case, *hawala* is likely not a strategic threat. It should be expected and understood that indigenous Muslims prefer, trust and primarily utilize such informal methods for finance such as *hawala*. Muslims will always desire to conduct business in the same manner that Mohammed did.

A second important variable is the vitality of the formal banking sector. For instance, in Afghanistan, despite some measured success and slow reform, the formal financial sector is infantile. In remote areas of Afghanistan it is entirely non-existent. In

¹⁵⁶ Amit Sharma, Naval Postgraduate School, July 31, 2007.

this case study, Afghans by and large have no other choices. If a state or community lacks sufficient formal banking mechanisms that are proven, trustworthy and reliable, the reliance of its population on *hawala* can most likely be written off as necessary. In the absence of significant formal banking institutions, people must utilize *hawala* and similar methods for financial transactions. *Hawala* is imperative for the state to function.

A third primary factor to consider in analyzing the threat of *hawala* is the expatriate component of the *hawala* system. Certainly there are Afghans scattered throughout South Asia and the Middle East who are sending remittances home to family. While Afghanistan itself does not have a huge expatriate concentration like Dubai does, its position on the receiving end of expatriate remittances makes it an important variable. Whether it is Afghanistan and Pakistan receiving unknown scores of remittances through *hawala* or U.A.E. with millions of expatriates working in its state, the presence of expatriate remittances indicates a necessary function of survival for millions of workers. The transmittal of millions of dollars by expatriates to their families in remote parts of the region presents a hint of normalcy in *hawala* rather than a strategic threat of criminal abuse to America or its allies in the financial war on terrorism.

Fourth, as Thompson and others have laid out in great detail, the nexus of drug and terror is palpable. To the extent that *hawala* is being misused for criminal purposes in Afghanistan, particularly its volatile southern provinces such as Helmand, drugs are a predominant factor or variable to consider. From all accounts the flow of terrorist funds through *hawala* is minimal. The 9/11 Commission, Passas and others have proved that the 9/11 hijackers did not use *hawala*. Furthermore, scholarly literature on the matter suggests that al-Qaeda finances are more limited than many in the media initially thought. When *hawala* was used, it seems to be not as a measure of strategic exploitation or deception of western financial scrutiny, but rather because that is what was available in Afghanistan! However, to the extent insurgent or al-Qaeda funds do flow through *hawala*, certainly this case study has shown that beneath the cloak of drugs is the first place one should look.

H. AFGHANISTAN: POLICY MISSTEPS AND THE CULTURAL FALLOUT

The U.S. Treasury Department has totally failed to see social and cultural realities on the ground. Ironically, the Bush Administration found out the hard way that they had to rely on the same *hawala* network terrorists use to move money in Afghanistan to get anything done after the Taliban fell. A little historical perspective can go a long way. This sort of improper framing of the issue has plagued U.S. foreign policy and certainly its approach to *hawala*.

“During the decades of conflict, trust in the government was progressively eroded and transposed to kinship, ethnic, and other social connections.”¹⁵⁷ The gravitational pull of these ties is forceful. These social and ethnic ties bind the Afghan people, not the central government. It is in these contexts that the Afghan people want to conduct their business, not under the perceived interference of Kabul or the U.S. Treasury Department’s regulations. “Afghanistan’s political economy is so deeply constituted through regional and international associations that it would be a mistake to view it in a purely national context.”¹⁵⁸ Yet that is exactly what the U.S. is attempting to do through FATF regulations and DAB laws. It is a mistake that ignores the rich cultural history of Afghanistan.

Afghanistan is not hopeless. The government of Afghanistan is doing many things right. Formal sector reforms are moving nicely. However, any reform or regulation of the *hawala* sector must be done slowly and cautiously. Centuries of social memory cannot be erased. *Hawala works* in Afghanistan. *Hawala is embraced* by Islam. These are facts that should not be ignored but rather adroitly leveraged in Afghanistan.

The Afghanistan case study affirms the scholars’ school of thought on *hawala*. The crux of this school of thought rests in the core belief that regulation of *hawala* needs to be tempered with patience, regional collaboration, socio-economic and cultural sensitivity, and broader formal financial reform. Rushing to too quick of recommendations and regulation will not benefit the U.S. in its long-term efforts to defeat al Qaeda. If counter-terror efforts are to curb *hawala* usage for criminal elements without

¹⁵⁷ Thompson, 157.

¹⁵⁸ Ibid., 170.

denying its sanctity to legitimate users then reform must address Afghanistan's rich culture. Another tenet of the scholars' school of thought is that broader formal financial reform will have a more desired effect in reducing *hawala* misuse than direct external pressure and regulation on *hawala* through registration and licensing. This case study shows that Looney, Passas and Maimbo are correct. Regulation cannot achieve its desired effect without broad and gentle financial reform in all sectors of the Afghan economy. Lastly, as de Gourde emphatically states: you must account for the socio-economic and cultural effects of any *hawala* regulation. *Al Barakaat* is but one example of regulators not looking ahead and seriously considering the cultural second and third order effects of stamping out *hawala*. Heavy-handed regulation is disastrous. Afghanistan bears out the preeminence of socio-economic and cultural impact of poorly designed financial regulation. The scholars' school provides the most appropriate lens in which to analyze Afghanistan's *hawala* system.

Ultimately, the most important truth to glean from Afghanistan is the utter inefficacy of any reform that does not include the *hawaladars* themselves in the creative process. Due to the social constraints, business practices and history of self-regulation, it is imperative to have *hawaladar* support in any regulatory measures. Less than full endorsement and collaboration in regulatory legislation or enforcement will doom any such measures to failure. Trust must be earned. However, the government can reach out to *hawaladars* over time, heeding their advice, and slowly nudging them to the formal sector incrementally.

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IV. CONCLUSION: THE HAMMER AND THE OLIVE BRANCH

Ultimately the *hawala* system is not a strategic threat to the United States. While some illicit finance undoubtedly flows through its networks, the vast majority of its users are using it for honest and simple tasks for which there are no other means, especially in Afghanistan. Al-Qaeda's use of *hawala* to plan and finance 9/11 has been disproved and dismissed. This was largely the ill-bred assumption that caused *hawala* to draw the ire of the U.S. government in the first place. Most Afghans are financially illiterate. Afghans do not trust formal banking. They want to cloak their financial business in the Qur'an. Furthermore, formal sector reform is slow and even if Afghans did want to use formal institutions for remittances and other *hawala* transactions, it is not feasible for most of the country. There is plainly no strategic threat. *Hawala* is just what is most available to Afghans. The only strategic threat related to *hawala* in the Middle East and Muslim world is the very real alienation the U.S. will cause if it applies heavy-handed and culturally ignorant regulatory measures like it did in the *al-Barakaat* case. The U.S. must engage the *hawaladars*.

This conclusion looks at U.S. regulation efforts in addressing *hawala* as directed by the Department of the Treasury. After exploring U.S. measures to combat illicit abuse of *hawala*, it briefly revisits Afghanistan and further synthesizes the most cogent findings of the Afghanistan case study. Next, it identifies Pakistan and U.A.E. as cases where further research is warranted and succinctly explains their importance to the U.S. in the financial war on terror. Lastly, this conclusion draws out some final thoughts that bolster the findings of this thesis.

A. U.S. HAWALA REGULATORY EFFORTS

Hawala regulation is a "gross misstatement." It should be more aptly labeled, "combating illicit finances."¹⁵⁹ If the U.S. is going to wage an effective "War on Financial Terror", then it must remove itself from the appearance of heavy-handed

¹⁵⁹ Amit Sharma, Naval Postgraduate School, July 31, 2007.

regulation of *hawala*. The government must stop attempts to stamp out *hawala* and other informal mechanisms with measures such as EO 13224 and examine more closely the financial boxes around these transnational threats. American policy must address systemic threats. *Hawala* is not a systemic threat. It is certainly abused by illicit users and terrorist financiers, but these incursions into the *hawala* system are an infinitely small minority. However, the results of over-extending U.S. endorsed international regulation in Afghanistan and elsewhere can have damaging social, cultural, and political ill effects. It presents a misleading paradigm for U.S. allies and those the U.S. desires to enlist as allies in the metaphorical “war on terror”: we extend the olive branch while wielding a deadly hammer with the other hand.

1. Financial Action Task Force (FATF)

“The U.S. is good at dropping the hammer... and the hammer is needed...but we don’t provide financial alternatives.”¹⁶⁰ FATF recommendations are broad, blunt instruments. EO 13224 and portions of the PATRIOT ACT are too broad and blunt to appropriately combat the intricate financial details of each Muslim country. One cannot apply the same declarations on *hawala* that are used in Dubai on the *hawaladars* of Kabul. *Hawala* in Kabul is not *hawala* in Quetta is not *hawala* in Abu Dhabi. To deter illicit abuse by terrorists in Afghanistan, any *hawala* regulation, registration, or oversight must be taken in the context of Afghanistan alone. Labels matter. When the Treasury Department or the Department of State label an organization a terrorist organization that affects how the U.S. can engage it. The FATF regulations suggested in the aftermath of 9/11 – 2006 have created a prosecutorial approach, especially in the U.S., that has almost created a financial body-count mentality. Success has equated to the number of “terrorist” organizations shut down. While many of these entities may have been connected financially with terror groups, one must account for the legitimate goods and services provided by these same “terrorist” financiers. In rural and financially handicapped countries like Afghanistan, the U.S. must provide better alternatives if it is going to eliminate one mechanism or means of financial transaction. One must look no

¹⁶⁰ Amit Sharma, Naval Postgraduate School, July 31, 2007.

further than *al Barakaat* in Somalia to witness the ill taste in the mouths of Muslims in the aftermath of EO 13224's blunt prosecution of that case.

2. What's the Alternative?

Providing an alternative has been a big failure on the part of the United States. *Al Barakaat* is but one example of the disaster that can follow in the wake of the U.S. Treasury Department's prosecutorial mindset in pursuing illicit finances through *hawala*. Somalia, by all accounts a failed state, relied heavily on the *hawala* network of the *al Barakaat* firm. There was literally no formal sector for financial transactions or remittances. The U.S. shut down *al Barakaat* by financially strangling its ability to interact with any bank or financial network. To this day, the U.S. has not been able to indict or convict one person from *al Barakaat* for complicity with terrorist financing. One would not expect to find any sympathy among the people of Somalia for the U.S. in its war on terror with that opening engagement with the people of Somalia. *Al Barakaat* remains shut down today.

The idea of administrative sanctioning tools is to stop the behavior. It should not be to wipe out organizations that are imperative in Afghanistan and throughout the Middle East. The U.S. has been able to stamp out *hawala* or enforce heavy-handed regulation in U.A.E. and elsewhere, but that fails to account for the cultural and economic negative impact in the countries where the U.S. pursues *hawala* regulation.

It is an utter failure of the U.S. government to offer competitively sustainable solutions. We wield the hammer effectively, but we don't offer solutions for the services provided by Hamas or Hezbollah for example.¹⁶¹

Illicit use of the *hawala* system cannot be based on broad regulatory models. It must be specific to a given region or country.

¹⁶¹ Amit Sharma, Naval Postgraduate School, July 31, 2007.

B. REVISITING AFGHANISTAN: HAWALA TODAY

In 2004, 95% of financial transactions went through the *hawala* system. Even the deputy governor of Kabul had a cousin who worked as a *hawaladar*.¹⁶² The *hawala* system is amazing liquid. It is fast. It is reliable. Financial records and books are meticulous and detailed. Every transaction is annotated despite some anecdotal evidence to the contrary in popular literature on *hawala*. In addressing the abuse of *hawala* in Afghanistan, one must account for its utter importance both culturally to Afghanistan and to Islam. Any engagement of the *hawala* system must take into account its significance culturally.

Foremost, any regulation of the *hawala* system must engage the *hawaladars*. Both from a cultural and a practical standpoint, without there being an obvious Afghan face on the process of reform, it is utterly doomed to fail. The U.S. must recognize the extreme pressure on *hawaladars* from their peers. It is unlikely and moreover poor business acumen to cut off one bad transaction or questionable customer. *Hawaladars* cannot afford to be blacklisted. It is a system based on trust and reliability. The *hawala* network stands on the integrity of the names of the *hawaladars* that make up the system. The U.S. cannot expect *hawaladars* to isolate themselves out of their livelihood system.

There is still mistrust between hawaladars and regulators but certainly over time this has improved from right after 9/11. Sharma explains this maturation process:

One must remember that they are coming largely from a self-regulated environment, so being approached by formal regulators has brought on (understandably so) a bit of skepticism. That said, yes, more and more have registered (almost a hundred now), and thus are opening books, disclosing, and are being much more transparent than in the past. A good balance of incentives and enforcement can continue to improve this.¹⁶³

Also, whereas there used to be self-regulation only in Kabul, self-regulation is slowly but surely extending to all the provinces. To the extent that Looney and others have

¹⁶² Amit Sharma, Naval Postgraduate School, July 31, 2007.

¹⁶³ Amit Sharma, Email message to the Author. November 1, 2007.

suggested broader reforms are needed to push more business, including illicit business, away from *hawala*, results are uncertain. Some measured success has occurred, however:

Increased opportunities as the formal sector develops provide greater access through those channels at both retail and wholesale levels. That being said, most formal banking (and reform) continues to be at commercial, trade finance and development finance levels, so much of the retail stuff is still done in informal channels (*hawala*).¹⁶⁴

There are other impediments to transitioning some volume of financial activity away from *hawala*. One of the most severe hindrances is the illiteracy in Afghanistan. For those who are illiterate, the formal sector is simply not an option. The Treasury Department agrees:

Literacy is a *MAJOR* issue... so is financial literacy... let's not forget that the system (*hawala*) has worked for so many years because a lot of the technical knowledge of banking, et cetera is not needed by those who partake in the system. This is less true if you want to use formal banking.... This is indeed a major issue...

C. BEYOND AFGHANISTAN: AVENUES FOR FURTHER RESEARCH

Looking beyond Afghanistan's *hawala* system, two of the most important cases to delve further into are the U.A.E. and Pakistan. *Hawala* is prevalent throughout the Muslim world, especially in the Middle East and South Asia. The most relevant *hawala* systems to the U.S. led "war on terror" are Pakistan and U.A.E. Pakistan is important because of its strong Pashtun ties to Afghanistan which is the epicenter of U.S. kinetic operations in the larger "war on terror." Because of its tribal and Islamic roots, as well as its lawless and under-governed border regions with Afghanistan where the likes of bin Laden and other senior al Qaeda leadership are rumored to be hiding, Pakistan's *hawala* network is certainly worthy of future research. U.A.E. too is important because it is simple a regional financial powerhouse. Because of the millions of expatriates working

¹⁶⁴ Amit Sharma, Email message to the Author. November 1, 2007.

in the U.A.E. and sending millions of dollars home through *hawala*, further research is warranted into its overall *hawala* network. Additionally, U.A.E. has summarily agreed to U.S. regulatory pressure on a number of financial issues, namely *hawala*. It is worthy of a more exhaustive study to determine if U.S. led *hawala* regulation in the U.A.E. has positively impacted efforts to eradicate terrorist financing.

1. Pakistan

The focus of this thesis is specifically on the *hawala* system in Afghanistan and its complicity in illicit terrorist financing. Nonetheless, it is important to take a brief look at other potential case studies that may provide some answers or a different perspective in the financial “war on terror.” In some respects, to know the *hawala* system in Afghanistan is to know the Pakistan *hawala* system. This section serves three purposes: First, it looks at the volatile border region which this thesis asserts is basically one *hawala* network (there are differences between Afghanistan and non-border region *hawala* networks). Second, it looks briefly at Pakistan from a national perspective and assesses the *hawala* network from the macro-level. Lastly, it juxtaposes the Afghanistan case study’s four primary *hawala* variables with Pakistan’s *hawala* system and provides a preliminary assessment of how well the maxims of the Afghanistan case study hold true.

a. The Pashtun Belt and “Talibanistan”

Because of the way Afghanistan and Pakistan were divided by colonial powers, the rich and culturally vibrant Pashtun belt crosses between the two countries. With the countless number of insurgents crossing back and forth between the border, particularly in the south of Afghanistan and Pakistan, some are calling the region “Talibanistan.”¹⁶⁵ This is simply to suggest that to the extent the insurgent problem lies on both sides of the border, in “Talibanistan”, then the illicit and ethnic Pashtun *hawala* network also exists as one, both in Pakistan and Afghanistan.

¹⁶⁵ Johnson, “On the Edge of the Big Muddy,” 100.

The border region is problematic for a myriad of reasons. It is the poorest region in Pakistan. It is flooded with refugees. It is largely an ungoverned or under-governed space. Its high poverty and unemployment rates make it an economy largely “dependent on smuggling as well as narcotics and weapons trafficking.”¹⁶⁶ It is because of this lawlessness and the scores of predominantly Afghan refugees that this border region of Pakistan must largely be read as one and the same as Afghanistan, economically-speaking. Johnson and others have forcefully argued that: “there is little argument that the dynamics of the FATA¹⁶⁷ are closely tied to the continuing problems in Afghanistan, especially the Taliban insurgency.”¹⁶⁸ This thesis adds to that the likelihood that the same ethnic dynamics that dominate the insurgent situation also follow suit in regards to *hawala*. Pakistan’s border *hawala* network is inextricably intertwined with Afghanistan’s because of the strong Pashtun ties.

The same as any combat operations to root out the insurgency in Afghanistan, any counter-terrorist financial measures meant to address the *hawala* system must take into account the complexities of the Pashtun belt and *Pashtunwali*.¹⁶⁹ Thompson reaffirms the importance of the Afghanistan-Pakistan *hawala* connection:

It is fair to deduce from discussions with hawaladars in Afghanistan that their links to Pakistan are crucial for their survival. As has already been demonstrated, a large part of the Afghan market relies heavily on Peshawar and Quetta as a conduit for delivery of money from places further afield. NGOs and other international agencies- important customers of Afghanistan’s *hawala* system- frequently send their funds to Pakistan where the money is deposited and can be received in Afghanistan only hours later...of course there are also the drug payments to Afghan traders, which depend to a large extent on in follows from Pakistan.¹⁷⁰

¹⁶⁶ Johnson, “On the Edge of the Big Muddy,” 112.

¹⁶⁷ Federally administered Tribal Area (FATA) that runs along the northwest border between Afghanistan and Pakistan.

¹⁶⁸ Johnson (2007), 116.

¹⁶⁹ *Pashtunwali* literally means “the way of the Pashtun.”

¹⁷⁰ Thompson, 182.

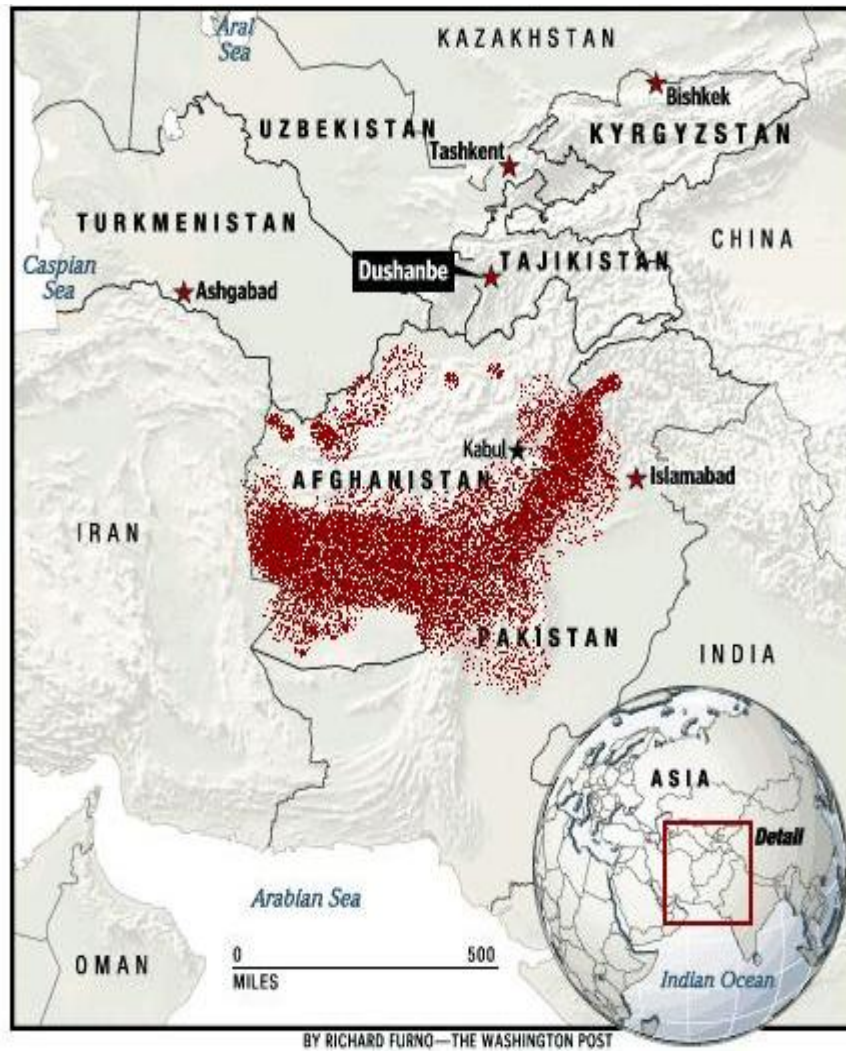


Figure 8. The Blurred Pashtun Border Between Pakistan and Afghanistan
(From: Richard Furno, *Washington Post* and Thomas Johnson)



Figure 9. Major Regional Ethnic Groups (From: Thomas Johnson)

b. Pakistan's Hawala from a Macro Viewpoint

With increased regulation of *hawala* in U.A.E. there has been a ripple effect in Central Asia and throughout Pakistan. Due to new stringent reporting requirements in Dubai the *hawala* system in Pakistan has been greatly affected. “Hawala business is 75% gone now,” according to Malik Bostan, president of the Forex Association of Pakistan, a Karachi-based trade group.¹⁷¹ The crackdown in Dubai has forced *hawaladars* throughout Pakistan to consider other forms of business because they just are not receiving the same volume of transactions through the *hawala* system as they used to. Banking experts in Pakistan estimate that \$11 million of expatriate remittances

¹⁷¹ Naweel Mangi, “Pakistan Cripples the Money Movers,” Business Week Online January 31, 2002. http://www.businessweek.com/bwdaily/dnflash/jan2002/nf20020131_6995.htm (accessed May 2007).

go through the *hawala* system per year, while only \$1 million goes through official banks. Reports suggest official channel remittances have tripled since the Dubai crackdown but there's still a huge gap in between what the *hawala* serviced previously and what the official banks are servicing in the way of remittances now.¹⁷² The flood of American dollars into Pakistani banks as official remittance channels receive more business will strengthen the rupee versus the dollar. Following U.A.E.'s lead, the State Bank of Pakistan has also initiated banking reforms aimed at thwarting illicit *hawala* transactions.

The initial impetus came from the U.S. crackdown... Banks have now...positioned themselves to distribute remittances very quickly to families in Pakistan.¹⁷³

From a macro perspective, the *hawala* system has been hampered greatly by international pressure and Dubai-originated reform. At the national level, financial experts and government officials are happy to see the *hawala* system degraded if it will bolster the rupee and created greater international transparency.

c. Is Pakistan's Hawala A Strategic Threat?: Assessing the Applicability of Afghanistan's Primary Hawala Variables

First, Pakistan is an Islamic state at its core. Islam reverberates throughout its society. Furthermore, as highlighted earlier, Pakistan largely shares its Pashtun culture with its Afghan neighbors. Like Afghanistan, the prevalence of Islam and its importance to the lives of everyday Pakistanis suggests benign usage of *hawala*. It is in a cultural and spiritual context in which *hawala* is used and this does not indicate explicit misuse by terrorist entities or present a strategic threat to the U.S. One should to some degree expect heavy *hawala* usage in Pakistan. This heavy *hawala* traffic should not

¹⁷² Naweens Mangi, "Pakistan Cripples the Money Movers," Business Week Online January 31, 2002. http://www.businessweek.com/bwdaily/dnflash/jan2002/nf20020131_6995.htm (accessed May 2007)..

¹⁷³ Ishrat Husain, governor of the Bank of Pakistan, as quoted in "Pakistan Cripples the Money Movers," Business Week Online January 31, 2002. http://www.businessweek.com/bwdaily/dnflash/jan2002/nf20020131_6995.htm (accessed May 2007).

necessarily be considered an indication of criminal abuse by terrorists but instead a reflection of the centrality of Islam to Pakistani culture.

Second, in examining the robustness of the formal financial sector, one can make similar conclusions to those drawn from the Afghanistan case study. Though Pakistan has a much more vibrant formal sector, there are still a plethora of remote locations that must rely on *hawala* such as the FATA and under-governed border regions with Afghanistan. Perhaps a more exhaustive case study of Pakistan would demonstrate more cause for concern if significant traffic spikes occurred in more urban *hawala* networks where there are reputable banks, but overall, the second variable drawn from the Afghanistan case study appears to be more true than false in Pakistan.

Third, like Afghanistan, a struggling economy and economic opportunities elsewhere have left Pakistan on the receiving end of millions of dollars in expatriate remittances. As a large percentage of this volume is remittance traffic, Pakistan's *hawala* network as a whole does not seem to be a threat externally. Pakistanis are strewn across the Gulf region and Asia and this should understandably create significant *hawala* traffic back to Pakistan.

Finally, drugs are a factor that is also dominant in Pakistan. As Johnson explains, the shared identity and Pashtun nature of the border region that he calls "Talibanistan" is likely rampant with the same abuse that occurs on the Afghan side. As both sides of the border are culturally linked, certainly Pakistan's *hawala* system is in places infused with drug and terror money. Perhaps a more exhaustive study of the nexus of drugs and *hawala* specifically focused on Pakistan's side of the border would draw similar conclusions to Thompson's seminal contribution to the literature concerning Afghanistan's *hawala* network. The focus of this thesis is not Pakistan, but further study of Pakistan's *hawala* should explore abuse of the system by terrorists here first where it converges with the drug underworld.

2. U.A.E.

U.A.E. received great pressure from the United States of America after 9/11 to closely watch and clamp down on the illicit use of the *hawala* system for terrorism

financing. U.A.E. was quick to jump on the U.S. bandwagon. The focus of this thesis is not on U.A.E.'s *hawala* system, but rather on Afghanistan's *hawala* system. U.A.E.'s network is much different than Afghanistan's or any other *hawala* network. U.A.E. boasts a much more robust formal financial sector. Nonetheless it is worth taking a quick look at the problems and reform initiatives that have been undertaken in the U.A.E. and briefly applying the four primary variables gleaned from the Afghanistan case study.

a. International Conferences on Hawala

Among other things, U.A.E. hosted the 1st International Conference on *Hawala* May 15-16, 2002, in Abu Dhabi. The conference was attended by 58 countries and it resulted in a declaration of the participating countries and persons. The Abu Dhabi Declaration on *Hawala* in part reads:

- Recognizing the need to better understand *hawala* and other informal remittance systems and to ensure that this system is not abused by money launderers and terrorist financiers, the Government of the United Arab Emirates brought together experts and representatives of the international regional bodies and regulatory and law enforcement agencies as well as bankers and money changers, in Abu Dhabi on May 15-16, 2002...
- However participants also raised concerns about *Hawala* and other informal remittance systems, noting that a lack of transparency and accountability, as well as the absence of governmental supervisions, presents the potential for abuse by criminal elements.
- Countries should adopt the 40 Recommendations of the Financial Action Task Force (FATF) on Money Laundering and the 8 Special recommendations on Terrorist Financing in relation to remitters, including hawaladars and other alternative remittance providers.
- Countries should designate supervisory authorities to monitor and enforce the application of these recommendations...
- The international community should remain seized with the issue and should continue to work individually and collectively to regulate the *Hawala* system for legitimate commerce and to prevent its exploitation or misuse by criminals and others.¹⁷⁴

¹⁷⁴ Abu Dhabi Declaration on *Hawala*, 2002, <http://www.treas.gov/offices/enforcement/programs/Hawala-conf.pdf> (accessed May 2007).

One could easily get bogged down in the plethora of legal documents that have emanated from the Central Bank of the U.A.E. regarding *hawala*. That misses the point. Rather, it should just be understood that the U.A.E. has staunchly backed American financial reform requests regarding misuse of the informal sector, namely *hawala*. The U.A.E. has been hand in hand with the U.S. Treasury Department in the financial aspect of the “war on terror.”

b. Registration

The International conferences on *Hawala* have continued with one in 2004, 2006, and 2007. The themes have been consistent, though. One of the first measures taken by the Central Bank of the U.A.E. was to begin registering *hawaladars* voluntarily. Furthermore, the Central Bank has tried to solicit the information of the remitters and beneficiaries to keep in a central database. Additionally, it has become a requirement for a *hawaladar* to report any suspicious transaction. Government officials have tried to assure the *hawaladars* that their personal information will be kept securely with the Central Bank, but it remains unclear how reassuring these promises have been. Lastly, any transaction done through the Central Bank will require a certificate that will be issued to all *hawaladars*.¹⁷⁵

U.A.E. has aggressively engaged the *hawala* system in its country with far-reaching effects. With continual anti-money laundering and *hawala* legislation, it has set itself apart as the leading *hawala* regulating country. As a leading financial hub for the Middle East as well as the world, the second and third order effects of its regulations have hampered *hawala* systems throughout the world, but especially in the Middle East. While this thesis doesn’t focus on the U.A.E., it provides a snapshot over another perspective on *hawala* regulation. U.A.E. regulation is much more aggressive than in Afghanistan or Pakistan. But, with a robust formal sector, it can afford to be. With that

¹⁷⁵ Central Bank of the U.A.E., “Hawala Regulations in the U.A.E.”, <http://www.centralbank.ae/AMLSU.php> (accessed June 2007).

in mind, it seems a much less useful model for anti-terrorism financial measures in somewhere like Afghanistan, where often, there literally is no other alternative to *hawala* for the average person.

c. *The U.A.E. Hawala Threat: Applying The Four Variables From Afghanistan*

U.A.E. is different than Pakistan and Afghanistan. One can find all four variables present, but with much different points of emphasis. First, U.A.E. is also operating within an Islamic framework. However, this paradigm is not necessarily as dominant as in Pakistan or Afghanistan. The second variable, the formal financial sector, is so robust that this factor tends to be dominant along with the expatriate variable. Because of its close ties to the U.S. and its widespread regulatory efforts post-9/11, the formal financial sector and regulatory factor has dominated the *hawala* network in U.A.E. The government has made significant efforts to stamp out or push aside *hawala* traffic in U.A.E. but as pointed out earlier, because of the plethora of reliable, readily available and westernized financial institutions, the ill effects of over-regulation have been mostly negligible. Simply due to the sheer enormity of the financial epicenter in Dubai it seems clear that in this model *hawala* is definitely no strategic threat. In the voluminous financial traffic that flows in and out of U.A.E. there are countless alternative means to conduct business ensuring that *hawala* remains largely on the periphery of the financial world. Like Pakistan and Afghanistan, *hawala* is still culturally preferable, but the difference is that U.A.E. positively provides a superfluity of other options for remittances and financial transactions. The last variable, drugs, is evident but is nowhere near the menacing frontier that it is in Pakistan or lawless Afghanistan. By comparison, U.A.E. has a well-functioning government, enforced laws and regulations, and an educated population with a much higher financial acumen. Though U.A.E.'s *hawala* system is starkly different than Afghanistan or Pakistan, it would be wise to approach it through the same four-variable framework.

D. FINAL THOUGHTS: POLICY CRITIQUES AND CULTURAL IMPLICATIONS

The U.S. Treasury Department has totally failed to see social and cultural realities on the ground. Ironically, after the fall of the Taliban, the Bush Administration found out the hard way that they had to rely on the same *hawala* network utilized by terrorists in order to move money in Afghanistan or to get anything done. A little historical perspective can go a long way. The complete cultural ignorance by the U.S. government to the importance of the *hawala* system in Afghan or Muslim society was completely avoidable. There are numerous historical examples and colonial narratives that illustrate the deep meaning of *hawala* to the Afghan way of life. This sort of improper framing of the issue has plagued U.S. foreign policy in the region and certainly its approach to *hawala*, too.

“During the decades of conflict, trust in the government was progressively eroded and transposed to kinship, ethnic, and other social connections.”¹⁷⁶ Afghans are ethnically aligned first and foremost, then they are Muslims, and last of all they consider themselves Afghan citizens. Once more, the gravitational pull of these ties is monumentally forceful. These social and ethnic ties bind the Afghan people, not the central government. It is in these contexts that the Afghan people want to conduct their business, not under the perceived interference of Kabul or the U.S. Treasury Department’s regulations.

Afghanistan’s political economy is so deeply constituted through regional and international associations that it would be a mistake to view it in a purely national context.¹⁷⁷

Yet that is exactly what the U.S. has attempted to do through FATF regulations and DAB laws. It is a serious blunder that ignores the rich cultural history of Afghanistan.

¹⁷⁶ Thompson, 157.

¹⁷⁷ Ibid., 170.

Hawala regulation also appears steep in “mirror imaging.”¹⁷⁸ There seems to be a belief that universal regulation, blunt tools such as the PATRIOT ACT, EO 13224, or those offered in the FATF special recommendations are going to ubiquitously act as penicillin for the incongruities and faults of *hawala* networks throughout the world. This is false and a disastrous cognitive pretext for reform.

Perhaps the most important truth to glean from Afghanistan is the utter inefficacy of any reform that does not include the *hawaladars* themselves in the creative process. Due to the social constraints, business practices and history of self-regulation, it is imperative to have *hawaladar* support in any regulatory measures. Less than full endorsement and collaboration in regulatory legislation or enforcement will doom any such measures to failure. Trust must be earned. However, the government can reach out to *hawaladars* over time, heeding their advice, and slowly nudging them to the formal sector incrementally. Reform must slowly occur in formal financial sectors, but must also include financial education and literacy, and be accompanied by several iterations of corruption-free government. Terrorist-free informal financing in Afghanistan will be a slow, collaborative effort led by the *hawaladars* as trust is formed with the central government and the legal frameworks of Afghanistan slowly garner legitimacy. It must take place within the context of Afghanistan, though.

It is a mistake to over-regulate *hawala*, and to the extent that it must be regulated, the greatest cultural deftness must be employed. If the U.S. is to curb Islamic “extremism” and *jihadism* in its “war on terror” than it absolutely cannot afford to continue offering an olive branch to moderate Muslims even as it wields a blunt and deadly financial hammer in the other hand.

¹⁷⁸ Samuel M. Maimbo (2005), 62.

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